COUNCIL AGENDA: 3/21/23 FILE: 23-404 ITEM: 3.3



#### Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

**FROM:** Julia H. Cooper

**DATE:** March 13, 2023

SUBJECT: STUDY SESSION: ELECTED

OFFICIALS' ROLES AND RESPONSIBILITIES IN

MUNICIPAL BOND DISCLOSURE

Approved Date 3/14/2023

#### **RECOMMENDATION**

Accept the presentation "Elected Officials' Roles and Responsibilities in Municipal Bond Disclosure".

#### **SUMMARY AND OUTCOME**

Acceptance of the presentation will inform the City Council on their roles and responsibilities regarding municipal bond disclosure. Training for staff and governing boards complies with the Administration Disclosure Policies and Procedures<sup>1</sup> and advances the Debt Management Policy<sup>2</sup> objectives.

#### **BACKGROUND**

The City Council Debt Management Policy 1-15 outlines the City policy commitment to full and complete disclosure of financial information and other information relevant to investors in the issuance of new debt and administration of existing debt. Additionally, the Policy requires City Council/City of San José Financing Authority/Successor Agency to the Redevelopment Agency review and approval of the Offering Document/Official Statement for bond issuances. The approving board is based on the issuer of the bonds. The Policy requires the Administration to develop and maintain detailed written policies and procedures which includes guidelines for regular training for City Council and key City staff. Finally, the Policy identifies the officials

<sup>&</sup>lt;sup>1</sup> Disclosure Policies and Procedures in City's Administrative Policy Manual - <u>CPM 7 Disclosures Policies and Procedures (sanjoseca.gov)</u>

<sup>&</sup>lt;sup>2</sup> Debt Management Policy, Council Policy 1-15 - <a href="https://www.sanjoseca.gov/home/showpublisheddocument/12869/636669975466830000">https://www.sanjoseca.gov/home/showpublisheddocument/12869/636669975466830000</a>; amendments to the Debt Management Policy are recommended as separate item on the March 21, 2023 Agenda.

HONORABLE MAYOR AND CITY COUNCIL

March 13, 2023

Subject: Elected Officials' Roles and Responsibilities in Municipal Bond Disclosure

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designated to communicate information concerning the City that may be material to investors – the City Manager and Director of Finance are the City's sole designated officials.

The presentation at the March 21, 2023 City Council meeting is part of the regular training for the City Council. On March 15, 2023 a training is scheduled for City Senior Staff and individuals throughout the organization responsible for assisting the development and review of municipal bond disclosure document(s).

#### **ANALYSIS**

The Director of Finance, representatives from Jones Hall, bond and disclosure counsel for the City, and the City Attorney's Office will present the materials and be available to answer questions.

The presentation outline is as follows:

- Introduction
- Overview of Municipal Bonds & Key Players
- Overview of Federal Securities Laws
  - Key Laws
  - SEC Perspective on Municipal Market
  - Enforcement Actions
- Elected Officials' Role in Municipal Bond Disclosure
- City Disclosure Policies and Procedures
- Conclusion
- City Council Discussion

Additional information on the City debt portfolio as of June 30, 2022 are in the Comprehensive Annual Debt Report posted on the Finance Department webpage.<sup>3</sup>

#### **EVALUATION AND FOLLOW-UP**

Periodic training will be provided to the City Council regarding its roles and responsibilities in municipal bond disclosure; a refresh on the City Council roles and responsibilities is provided at the time of City Council approval of each municipal bond issuance.

<sup>&</sup>lt;sup>3</sup> FY 2022 Comprehensive Annual Debt Report - https://www.sanjoseca.gov/home/showpublisheddocument/92714/638055795782970000

HONORABLE MAYOR AND CITY COUNCIL

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#### **COORDINATION**

This memorandum was coordinated with the City Attorney's Office.

#### **PUBLIC OUTREACH**

This memorandum along with the presentation materials will be posted on the City's Council Agenda website for the March 21, 2023 City Council meeting.

#### **COMMISSION RECOMMENDATION AND INPUT**

No commission recommendation or input is associated with this action.

#### **CEQA**

Not a Project, File No. PP17 008, General Procedure and Policy Making resulting in no changes to the physical environment.

#### **PUBLIC SUBSIDY REPORTING**

This item does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code or the City's Open Government Resolution.

/s/ JULIA H. COOPER Director of Finance

For questions, please contact Julia H. Cooper, Director of Finance, at (408) 535-7011.

Attachment – Elected Officials' Role in Municipal Bond Disclosure Overview of Municipal Bonds and Securities Laws Presentation

COUNCIL AGENDA: MARCH 21, 2023

ITEM: 3.3

FILE: 23-404

## ELECTED OFFICIALS' ROLE IN MUNICIPAL BOND DISCLOSURE

#### OVERVIEW OF MUNICIPAL BONDS AND SECURITIES LAWS





#### **OVERVIEW**

- Introduction
- Overview of Municipal Bonds & Key Players
- Overview of Federal Securities Laws
  - Key Laws
  - SEC Perspective on Municipal Market
  - Enforcement Actions
- Elected Officials' Role in Municipal Bond Disclosure
- City Disclosure Policies and Procedures
- Conclusion
- City Council Discussion



#### INTRODUCTION

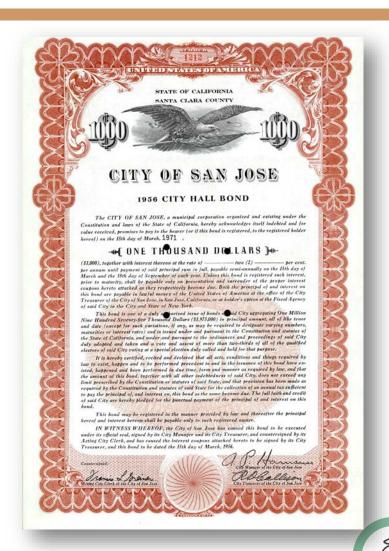
- Presentation Participants
  - Julia H. Cooper Director of Finance
  - Rosa Tsongtaatarii Chief Deputy City Attorney
  - Katie Dobson Jones Hall, Shareholder
  - Juan Galvan Jones Hall, Shareholder





### OVERVIEW OF MUNICIPAL BONDS

- What are municipal bonds?
  - Debt instrument, similar to a loan
  - Investors in the municipal market lend money to government agency (issuer)
  - Issuer promises to repay face value (principal) plus interest when the bond matures or becomes due





#### OVERVIEW OF MUNICIPAL BONDS

- Money is used to build public capital projects, such as libraries, police stations, fire stations, airports, and wastewater systems
- Generally, interest paid to bond owners on municipal bonds is taxexempt if certain conditions are met and IRS rules are followed by the Issuer



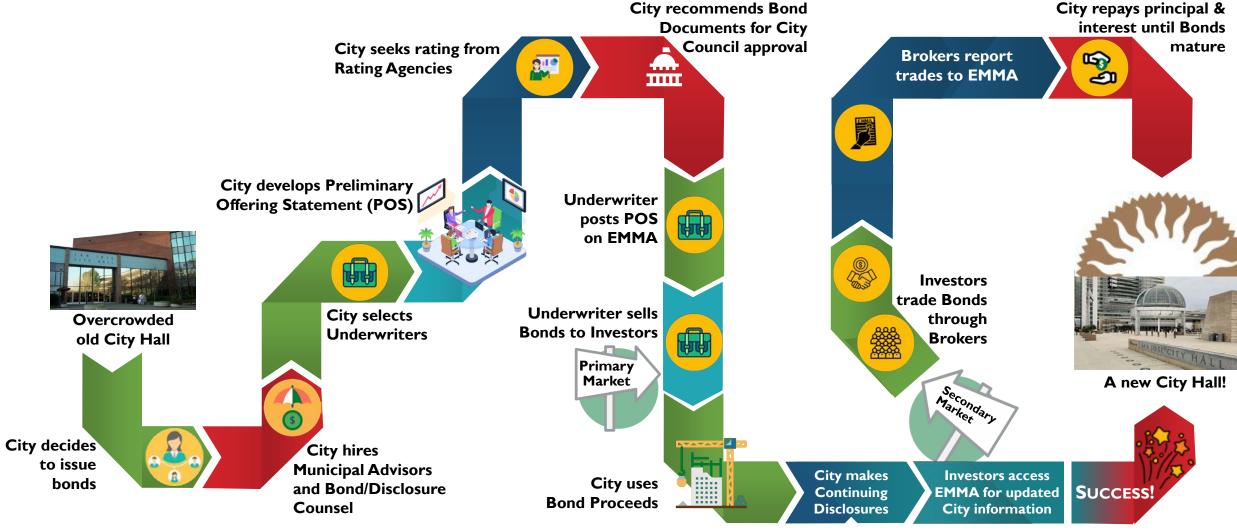








### **BUILDING CITY HALL**







## What Issuers of Municipal Securities Should Know about Federal Securities Laws





### KEY LAWS — SECURITIES ACT OF 1933

- Often referred to as the "truth in securities" law, has two basic objectives:
  - Increase Transparency: Requires disclosure of financial and other significant information concerning securities offered for public sale (i.e., requires registration of securities when first sold to the public)
  - Deter Fraud: Prohibits deceit, misrepresentation and other fraud in the sale of securities (including municipal securities)

Municipal securities are exempt from registration requirements of the 1933 Act but <u>not</u> anti-fraud provisions





## KEY LAWS — SECURITIES AND EXCHANGE ACT OF 1934

- Broadly regulates securities
- Anti-Fraud provisions:
  - Section 10(b): prohibits fraud in purchase or sale of securities
  - SEC Rule 10b-5: it is unlawful 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





## KEY LAWS — SECURITIES AND EXCHANGE ACT OF 1934

Supreme Court Definition of "material":

A statement or omission is material if there is a **substantial likelihood** (not a "possibility") that, under all the circumstances, the fact or omission **would** (not "could") have actual significance (must be important, not just "interesting") in the deliberations of the **reasonable** (not "any") **investor** 

Basic Inc. v. Levinson, 485 U.S. 224 (1998)





## KEY LAWS — SECURITIES AND EXCHANGE ACT OF 1934

- Pursuant to rulemaking authority, Securities & Exchange
   Commission (SEC) has promulgated SEC Rule 15c2-12
- Regulates
  - Initial (new issue) disclosure
  - Continuing disclosure
- Applies only to certain "publicly offered" municipal securities





### RULE 15c2-12: NEW ISSUE DISCLOSURE PRELIMINARY OFFICIAL STATEMENT (POS)

- Information concerning the terms of the securities and financial information or operating data material to an evaluation of the securities
- Prepared by the City with assistance of disclosure counsel and financing team participants
- Issuer's responsibility to ensure accuracy and completeness
- Approved by governing board of issuer City Council, City of San José Financing Authority, Successor Agency
- Must be "deemed final" by the issuer does not contain any material misstatement or omission

PRELIMINARY OFFICIAL STATEMENT DATED NOVEMBER 18, 2022

rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain coverants, interest on the Series 2022B Bonds is excluded from grass income for federal income tax purposes under Section 103 of the Internal Reviews Code of 1986 and a exempt from State of California personal income taxes. In the further opinion of Bod clause, interest on the Series 2022B Bonds is not a specific preference item for purposes of the federal individual alternative minimum tax. Bond Counsel observes that, for tax years beginning after December 31, 2022, interest on the Series 2022B Bonds included in adjusted financial statement income of certain corporations is not excluded from the federal corporate afternative minimum tax. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 2022B Bonds. See "TAX MATTERS."



CITY OF SAN JOSE FINANCING AUTHORITY WASTEWATER REVENUE BONDS, SERIES 2022E



The bonds captioned above (the "Series 2022B Bonds") are being issued by the City of San José Financing Authority (the "Authority"

The Series 2022B Bonds will bear interest at the rates shown on the inside cover page, payable semiannually on May 1 and November 1 of each year, commencing on May 1, 2023, and will be issued in fully registered form without coupons in integral multiples of \$5,000. The Series 2022B Bonds will be issued in book-entry only form, initially registered in the name of Cede & Co., as nomine of ITD. Purchasers of the Series 2022B Bonds will not receive certificates representing their interests in the Series 2022B Bonds. Payments of the principal of and interest on the Series 2022B Bonds will be made to UTC, which is obligated in turn to remit such principal and interest to its participants for subsequent disbursement to the beneficial owners of the Series 2022B Bonds. See "THE SERIES 2022B BONDS - Book-Entry Only System."

The Series 2022B Bonds are being issued pursuant to a Master Indenture, dated as of December 1, 2022, as supplemented by a First Supplemental Indenture, dated as of December 1, 2022, each between the Authority and Wilmington Trust, National Association, as trustee (the "Trustee") (as so supplemented, the "indenture"). The Series 2022B Bonds are limited obligations of the Authority payable from and secured by a piedge of the Revenues (as defined herein) and amounts on deposit in certain funds and accounts established under the Indenture. "Revenues" generally consist of installment payments (the "2022B Installment Payments") made by the City of San José (the "City") pursuant to a Master Installment Purchase Contract, dated as of December 1, 2022, as supplemented by a First Supplemental Installment Purchase Contract, dated as of December 1, 2022, each between the Authority and the City (as so supplemented, the "Installment Purchase Contract"). The City's Installment Payments under the Installment Purchase Contract, including the 2022B Installment Payments. are payable solely from, and secured by a piedge of, Net System Revenues (as defined herein) which generally consist of revenues les maintenance and operation costs of the City's sanitary sewer collection system and San José-Santa Clara Regional Wastewater Facility (excluding any revenues and costs of the South Bay Water Recycling Program System). The City is authorized to issue or create additional obligations payable from, and secured by the pledge of, Net System Revenues on a parity with the 2022B Installment Payments. The Series 2022B Bonds will not be secured by a debt service reserve fund or account. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2022B BONDS." The Series 2022B Bonds are subject to redemption before maturity. See "THE SERIES 2022B

NONE OF THE SERIES 2022B BONDS, THE OBLIGATION OF THE AUTHORITY TO PAY PRINCIPAL THEREOF OR INTEREST THE CITY OF THE STRING STRING THE CITY TO MAKE THE 2022B INSTALLMENT SYMMENTS CONSTITUTES EITHER A DEBT OR A LUBILITY OF THE AUTHORITY, THE CITY, THE STATE OF CALIFORNA OR ANY OF THEIR RESPECTIVE POLITICAL. SUBDIVISIONS WITHIN THE MEANING OF ANY CONSTITUTIONAL LIMITATION ON INDERTEDNESS, OR A PLEDGE OF THE FULL AITH AND CREDIT OF THE CITY OR THE AUTHORITY. THE CITY'S TAXING POWER IS NOT PLEDGED TO THE PAYMENT OF THE SERIES 2022B BONDS OR INTEREST THEREON. THE AUTHORITY HAS NO TAXING POWER

THIS COVER PAGE CONTAINS CERTAIN INFORMATION FOR GENERAL REFERENCE ONLY. IT IS NOT A SUMMARY OF THIS ISSUE OF SERIES 20228 BONDS. INVESTORS MUST READ THE ENTIRE OFFICIAL STATEMENT TO OBTAIN INFORMATION ESSENTIAL TO THE MAKING OF AN INFORMED INVESTMENT DECISION WITH RESPECT TO THE PURCHASE OF THE SERIES INVESTMENT IN THE SERIES 2022B BONDS INVOLVES RISKS THAT MAY NOT BE APPROPRIATE FOR SOM

The Series 2029 Bonds will be offered when as and if executed and delivered, and received by the Underwriters, subject to the approval as to their validity by Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority, and subject to certain other conditions Certain legal matters will be passed upon for the Authority and the City by the City Altornoy, and by Jones Hall, A Professional Law Corporation, San Francisco, California, as Disclosure Counsel. Certain legal matters will be passed upon for the Underwriters by their counsel, ArentFox Schiff LLP, San Francisco, California. It is anticipated that the Series 2022B Bonds in definitive form will be available for delivery to DTC in New York, New York on or about December 15, 2022.

Morgan Stanley

**Academy Securities** The date of this Official Statement is: December \_\_\_, 2022.

\* Preliminary, subject to change

Ramirez & Co., Inc.



## RULE 15c2-12: NEW ISSUE DISCLOSURE OFFICIAL STATEMENT (OS)

- Completed upon the sale of bonds
- Adds pricing-related information to POS
- Delivered to underwriter within 7 business days after sale date
- Often, only change from POS is final pricing information
- Between the distribution of POS and preparation of OS, events may occur that require updating the final OS

NEW ISSUE - FULL BOOK-ENTR'

RATINGS: S&P: "AAA"
Fitch: "AAA"
Kroll: "AAA"

In the opinion of Ornicis, Herrington & Sutrilife LLP, Bond Coursel to the Authority, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covernants, interest on the Series 2022B Bands is excluded from gross income for federal income lax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. In the further opinion of Band Coursel, interest on the Series 2022B Bonds is not a specific preference term for purposes of the federal individual alternative minimum tax. Bond Coursel observes that, for tax years beginning after December 31, 2022, interest on the Series 2022B Bonds included in adjusted financial statement income of certain corporates afforded from the federal corporate affective minimum tax. Band Coursel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accurate or receipt of interest on, the Series 2022B Bonds. See "T&M.MT.TERS."



CITY OF SAN JOSE FINANCING AUTHORITY
WASTEWATER REVENUE BONDS, SERIES 2022B
(GREEN BONDS – CLIMATE BOND CERTIFIED)





Dated: Date of Deliver

November 1, as shown on inside of

The bonds captioned above (the "Series 20228 Bonds") are being issued by the City of San Jose Financing Authority (the Authority's outlanding Subordinate Wastewater Revenue Notes, Series A, and (ii) pay the costs of issuing the Series 20228 Bonds. See "FINANCING PLAN" and "DESIGNATION OF THE SERIES 2022B BONDS AS GREEN BONDS —CLIMATE BOND CERTIFIED."

The Series 2022B Bonds will bear interest at the rates shown on the inside cover page, payable semiannually on May 1 and November 1 of each year, commencing on May 1, 2023, and will be issued in fully registered form without coupons in integral multiples of \$5,000. The Series 2022B Bonds will be issued in book-entry only form, initially registered in the name of Cade & Co., as nominee of The Depository Truct Company, New York, New York (PDTC). Purchasers of the Series 2022B Bonds will not receive certificates representing their interests in the Series 2022B Bonds. Payments to the principal of and interest on the Series 2022B Bonds. Payments to the principal can di interest to the Series 2022B Bonds will be made to DTC, which is obligated in turn to remit such principal and interest to its participants for subsequent disbursement to the beneficial owners of the Series 2022B Bonds. Series 2022B Bonds Series 2022B

The Series 2022B Bonds are being issued pursuant to a Master Indenture, dated as of December 1, 2022, as supplemented by a First Supplemental Indenture, dated as of December 1, 2022, each between the Authority and Wilmington Trust, National Association, as trustee (the "Trustee") (as so supplemented, the "Indenture"). The Series 2022B Bonds are limited obligations of the Authority apyable from and secured by a pledge of the Revenues (as defined herein) and amounts on deposit in certain funds and accounts established under the Indenture. "Revenues" generally consist of installment payments (the 2022B Installment Payments) made by a Chief Carlot of the C

NONE OF THE SERIES 2022B BONDS, THE OBLIGATION OF THE AUTHORITY TO PAY PRINCIPAL THEREOR INTEREST THEREON, AND THE OBLIGATION OF THE CITY TO MAKE THE 2022B INSTALLMENT PAYMENTS CONSTITUTES EITHER A DEBT OR A LIABILITY OF THE AUTHORITY, THE CITY, THE STATE OF CALIFORNIA OR ANY OF THEIR RESPECTIVE POLITICAL SUBDIVISIONS WITHIN THE MEANING OF ANY CONSTITUTIONAL LIMITATION ON INDEBTEONESS, OR A PLEDGE OF THE FULL FAITH AND CREDIT OF THE CITY OR THE AUTHORITY. THE CITY'S TAXING POWER IS NOT PLEDGED TO THE PAYMENT OF THE SERIES 2022B BONDS OR INTEREST THEREON. THE AUTHORITY HAS NO TAXING POWER.

THIS COVER PAGE CONTAINS CERTAIN INFORMATION FOR GENERAL REFERENCE ONLY. IT IS NOT A SUMMARY OF THIS IS OF SERIES 2022B BONDS. INVESTORS MUST READ THE ENTIRE OFFICIAL STATEMENT TO OBTAIN INFORMATION ESSENTIAL TO THE MAKING OF AN INFORMED INVESTMENT DESIGNO WITH RESPECT TO THE PURCHASE OF THE SERIES 2022B BONDS. INVESTMENT IN THE SERIES 2022B BONDS INVOLVES RISKS THAT MAY NOT BE APPROPRIATE FOR SOME MAJESTORS. SEE OFFETAIN BIFFE FACTORS.

The Series 2022B Bonds will be offered when, as and if executed and delivered, and received by the Underniters, subject to the approval as to their validity by Orrick, Hernignot a Studiffe LLP Bond Coursel to the Authority, and subject to certain other conditions. Certain legal matters will be passed upon for the Authority and the City by the City Attorney, and by Jones Hall, A Professional Law Corporation, San Francisco, California, as Disclosure Coursel. Certain legal matters will be passed upon for the Underwitters by their coursel, ArentFox Schiff LLP, San Francisco, California, at it is anticipated that the Series 2022B Bonds in definitive form will be available for delivery to DT Cin New York, New York on a about December 15, 2022.

Wells Fargo Securities

Norgan Stanley

Academy Securities

Ramirez & Co., Inc.

Stifel

The date of this Official Statement is: November 30, 2022





### RULE 15c2-12: CONTINUING DISCLOSURE

#### Annual report

- Updates to financial information and operating data of the type included in the OS as specified in written agreement signed by issuer (e.g. Continuing Disclosure Certificate)
- Audited financial statements, when and if available

#### Notice of Occurrence of Significant Events

- 16 specified events, including:
  - \* Principal and interest payment delinquencies
  - \* Rating changes
  - \* Unscheduled draws on debt service reserve funds
- See slide 42 in additional information section of this presentation for complete list

#### Method of Filing

 Electronic Municipal Market Access (EMMA) website established by Municipal Securities Rulemaking Board (MSRB)



### RULE 15c2-12: CONTINUING DISCLOSURE

- Issuers are required to disclose compliance with their continuing disclosure obligations in official statements
  - Municipalities Continuing Disclosure Cooperation Initiative (2014)
- Antifraud provisions apply to secondary market statements
  - Continuing disclosure reports
  - Statements "reasonably expected to reach investors and trading markets"
    - \* Budget Messages
    - \* Press releases
    - \* Web site postings





### SPEAKING TO THE MARKET

- Disclosure should be factual and neutral
- Do not include adjectives or "sales" language

The City is the oldest and most beautiful city in the State of California, developing from a momentous Spanish pueblo established in 1777. Situated between the rolling Diablo and Santa Cruz mountain ranges, the City encompasses approximately 180 square miles at the south end of the iconic San Francisco Bay and is the county seat of Santa Clara County, home to some of Silicon Valley's greatest minds. With an impressive 2018 estimated population of 1,051,316, the City is the third most populous city in the State and the tenth most populous in the United States. Visitors find many amenities in the City's revitalized downtown area including fine accommodations and world class restaurants and shops.



### SEC PERSPECTIVE ON MUNICIPAL MARKET

- Most actions brought under Securities Act of 1933
  - Only requires negligence
     Issuer or official knowingly misstated or omitted facts, or failed to discover facts that were available or could have been reasonably discovered
  - No requirement that SEC prove intent to defraud
- Historical Enforcement Priorities
  - Quality of financial disclosure
  - Timeliness of financial disclosure
  - Undisclosed potential tax violations



### SEC ENFORCEMENT ACTIONS -**ORANGE COUNTY**

In re County of Orange, California; Orange County Flood Control District and County of Orange, California Board of Supervisors,

Securities Act Release No. 7260, Exchange Act Release No. 36760, A.P. File No. 3-8937 (January 24, 1996).

#### Orange County's Fatal Error

The bankruptcy of Orange County, California - the biggest municipal bankruptcy ever - is turning chaotic. The county's investment fund.

rning principal stoff forced the nd tax refunds. to invest in the vice providers

. What caused milar episodes

uying complex, ves, whose valderlying bonds, Many observn that money-

ed. The fund's rities it bought, ky investment Freasurer, bralow short-term higher-yielding

ky gamble that d, Mr. Citron's lue of his longhe racked up ero by earning n other county ed, Mr. Citron iously Republit ridiculed Mr. But this year the redection of the redec But this year the Federal Reserve has been

derivatives or plain-vanilla stocks and bonds - Mr. Citron chose to trade. The strategy, not the securities, proved fatal.

What, then, was needed to stop him? Some members of Congress have picked the wrong answer: prohibiting county funds from purchasing derivatives or borrowing to purchase securities. The danger with such blanket prohibitions is that they rule out the use of derivatives and borrowing to reduce investment risk. Mr. Citron's mistake was to make one-way bets on the direction of interest rates. But prudent investment managers use the same tactics to insulate funds from movements in interest rates in either direction.

What Orange County needed was oversight. Mr. Citron was seemingly left to run amok. Arthur Levitt, chairman of the Securities and Exchange Commission, calls on state and local governments to monitor investment managers of taxpayer money. The primary objective of government funds must be safety and liquidity (the ability to convert investments into cash for emergencies), not profit. If fund managers were forced to assess and report risks, and government supervisors were responsible for overseeing the managers, then Orange County - one of the wealthiest in America - would not now be threatening to lay off teachers and nurses.



Los Angeles Times

Chapter 9 Move a Last Resort. Experts Say

S.E.C. Orange County Action Is Reported

SANTA ANA, Calif., Oct. 1 (Reuters) - The Securities and Exchange Commission has informed bond companies involved in several Orange County, Calif., note deals that it intends to recommend enforcement action against them, people familiar with the situation said last week.

The agency sent "Wells" notices to several bond firms, according to people who have received or reviewed the documents. A Wells notice tells recipients that the S.E.C. staff intends to recommend an enforcement action to commissioners and asks the parties involved to submit any reasons why the S.E.C. should not proceed.

The county issued \$600 million of

taxable notes in the summer of 1994. In December, it declared bankruptcy after suffering investment losses estimated at \$1.69 billion. The question for the S.E.C. is whether the prospectus for the notes accurately portrayed the financial condition of the county.

The S.E.C. is also looking at other note sales by localities that invested in the county's investment pool, the people said. The firms involved in the deals include Leifer Capital Inc.: Rauscher Pierce Refsnes: LeBoeuf. Lamb, Greene & MacRae; Rutan & Tucker and Merrill Lynch & Compa-

The first four companies were not available to comment. Merrill Lynch said it had no comment.







## SEC ENFORCEMENT ACTIONS – ORANGE COUNTY

- Risky investment strategies to balance budget
- Failed to disclose investments
- County filed for bankruptcy protection in 1994
- SEC brought enforcement action in 1996 did NOT involve the failure to pay any bonds





## SEC ENFORCEMENT ACTIONS – ORANGE COUNTY

SEC found Supervisors failed to take "steps appropriate under the circumstances" to assure that the County's financial situation was being adequately disclosed to potential investors

- "[A] Public official who approves issuance of securities and related disclosure documents may not authorize disclosure that the public official knows to be materially false or misleading"
- "[A] Public official may not authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading"





### SEC ENFORCEMENT ACTIONS - SAN DIEGO

#### **SEC Charges Five Former San Diego Officials with Securities Fraud**

#### FOR IMMEDIATE RELEASE 2008-57

Washington, D.C., April 7, 2008 — The Securities and Exchange Commission today filed securities fraud charges against five former San Diego city officials who played key roles in the city's inadequate municipal securities disclosures in 2002 and 2003. The SEC charged the former officials for failing to disclose to the investing public buying the city's municipal bonds that there were funding problems with its pension and retiree health care obligations and those liabilities had placed the city in serious financial jeopardy.



#### **NEWS**

#### **SEC Strikes Again**

by Voice of San Diego April 8, 2008

**Tuesday, April 8, 2008** | The Securities and Exchange Commission filed civil securities fraud charges against five former top city of San Diego officials Monday, a sudden revelation that jolted the yearslong investigations into City Hall, which once appeared dormant, back into full view.

#### The New Hork Times

### S.E.C. Sues 5 Ex-Officials in San Diego

#### **BY Reuters**

April 8, 2008

The Securities and Exchange Commission on Monday filed fraud complaints against five former San Diego city officials who played roles in the city's financial crisis in 2002 and 2003.





### SEC ENFORCEMENT ACTIONS - SAN DIEGO

- San Diego issued \$260 million through 5 bond issues in 2002 and 2003
- SEC alleged City officials had engaged in securities fraud for failing to disclose material information
  - Inadequately disclosed large unfunded liabilities for pensions and retiree health care
  - Officials falsely certified there were no material misstatements
  - Did not hire auditors with the skills and resources necessary to adequately audit City's financials in connection with its securities offerings





## SEC ENFORCEMENT ACTIONS – LESSONS LEARNED FROM SAN DIEGO\*

- Adopt disclosure policies and procedures
- Provide appropriate training to everyone involved in the disclosure process (e.g. City Council and staff)
- Focus on big picture issues facing the local agency
- Disclose the good with the bad
- Hire auditors with the skills and resources necessary to adequately audit local agency's financials in connection with its securities offerings

<sup>\*</sup> Excerpted from "Lessons Learned from San Diego", Linda Chatman Thomsen, Director, Division of Enforcement, SEC, December 11, 2007



## SEC ENFORCEMENT ACTIONS – PERSONAL LIABILITY

#### **Orange County**

- **Elected Treasurer**: SEC cease and desist order; 6 years in jail, \$100,000 fine
- Assistant Treasurer: SEC cease and desist order; 3
  years in jail; \$10,000 fine

### San Diego

• Four officials (City Manager, Deputy City Manager, Auditor & Comptroller, City Treasurer) consented to entry of judgment and paid civil penalties ranging from \$5,000 to \$25,000.







## SEC ENFORCEMENT ACTIONS – PERSONAL LIABILITY

Since 2010, SEC has stepped up enforcement against municipal issuers

and officials

- Civil Fines Imposed on Issuers from \$20,000 to \$1 Million (Miami)
- Civil Fines Against Officials from \$10,000 to \$50,000
- Barring Officials to work on future bonds
- SEC Public Finance Abuse Unit expanded efforts in FY 2022 with one of most significant developments – increased focus on municipal issuers
  - Previous two years most of enforcement activity focused largely financial advisors and underwriters
  - These actions involved municipal issuers and their employees, and in most
     cases their financial advisor as well

## ELECTED OFFICIALS' ROLE IN MUNICIPAL BOND DISCLOSURE





#### RESPONSIBILITY OF ELECTED OFFICIALS

- Review the primary disclosure document for information on key topics:
  - Purpose of the bonds
  - Sources of repayment
  - Risks that the sources of repayment may be insufficient to repay the bonds
  - Discussion of any other events or information that could affect the deliberations of a reasonable investor
- After such review of the document the following additional elements should be considered:
  - Have identified material risks and events been brought to the attention of staff, bond counsel and other professionals?
  - Have such risks and events been disclosed, and if not, what is the rationale for the non-disclosure?

### RESPONSIBILITY OF ELECTED OFFICIALS

If any Councilmember or Authority Board member has any personal knowledge that any of the material information in the Official Statement is or may be false or misleading, the Councilmember/Authority Board member must raise these issues prior to approval of the distribution of the document.





# DISCLOSURE BEST PRACTICES AND CITY OF SAN JOSÉ'S APPLICATION OF BEST PRACTICES





### DISCLOSURE POLICIES & PROCEDURES

- City Council adoption of Debt Management Policy\* outlining disclosure practices and procedures
- City Administrative Disclosure Policies and Procedures\*\*
- Policies and Procedures:
  - Designates <u>only</u> the City Manager and Director of Finance as having the responsibility for "speaking to the market" on behalf of the City
  - Establish Internal Controls and Systems
  - Identify "disclosure documents" information reasonably expected to reach investors/trading markets
  - Require staff brainstorming sessions to discuss "big picture"



<sup>\*\*</sup> Disclosure Policies and Procedures, Section 7 https://www.sanjoseca.gov/home/showpublisheddocument/61169/637292207533100000



## DISCLOSURE POLICIES & PROCEDURES KEY REQUIREMENTS

- Transmit the POS to legislative body early enough to provide legislative body sufficient time to review and ask questions
- Disclose bad news
- Provide practical training to officials and employees from City Council/board members to staff members





### **SUMMARY**

- San José team takes seriously the responsibility of full and complete disclosure
  - Engage subject matter experts throughout the organization
- Historically seasoned and experienced finance management team
  - Evolving process over last 20+ years
  - Policies and procedures help ensure compliance with applicable securities laws





### COUNCIL DISCUSSION





### **ADDITIONAL INFORMATION**





- **Bond owner** owner of the bond
  - Individuals (aka "mom and pop" or retail investors, including very wealthy individuals)
  - Institutions such as banks, insurance companies, mutual funds and corporations
  - Generally entitled to receive regular interest payments and return of principal when bond matures





- City Staff contributors to disclosure
  - City Manager for global view of affairs of the City
  - City Attorney for litigation risks
  - Director of Finance
  - Budget Director
  - Most City departments review and contribute to disclosure
    - \* Staff typically has the most current and relevant information
    - \* Input is critical to the disclosure process





- Municipal Advisor advises issuer on structure, marketing and sale of bonds
  - Has fiduciary obligations to the issuer
  - Assists issuer with hiring other members of financing team,
     determining need for dissemination agent or other consultant
  - Assists issuer with projected financial information and impact of planned future financings
  - Reviews POS/OS, but does not have affirmative due diligence obligation under federal securities laws





- Bond Counsel hired by the issuer to prepare legal documents, provide legal advice to the issuer and deliver legal opinions:
  - Bonds are valid and binding obligations of issuer
  - In case of tax-exempt bonds, bonds are exempt from federal and state income taxes
- <u>Disclosure Counsel</u> hired by the issuer to assist with the preparation of the official statement and provide advice to the issuer regarding compliance with Federal securities laws





- Trustee financial institution acts in a fiduciary capacity for the benefit of the bond owners including enforcement of the terms of the bonds
- <u>Underwriter/Purchaser</u> purchases the bonds from the issuer for resale to investors has no fiduciary responsibility to the issuer, but has due diligence obligation under federal securities law; hires legal counsel to represent the underwriters interest





### **KEY ACRONYMS**

Acronym	Definition
ACFR	Annual Comprehensive Financial Report
EMMA	Electronic Municipal Market Access, municipal disclosure website sponsored by MSRB
MSRB	Municipal Securities Rulemaking Board
OS	Official Statement
POS	Preliminary Official Statement
SEC	Securities & Exchange Commission





## SEC ENFORCEMENT ACTIONS — MUNICIPALITIES CONTINUING DISCLOSURE COOPERATION

- Municipalities Continuing Disclosure Cooperation (MCDC) Initiative announced in 2014 with goal of encouraging self reporting of disclosure violations by issuers, obligated persons and underwriters
- Participants in MCDC Initiative were offered standardized settlement terms
- Settlement terms for issuers and obligated persons included:
  - Cease and desist proceeding with no admission or denial of findings
  - Establishing continuing disclosure compliance policies and training
  - No payment of a civil penalty
- Initiative did not cover individuals and they remained exposed to potential SEC enforcement





### RULE 15C2-12 - LISTED EVENTS

Always Require Notification	Require Notification If Material
Issuance by the Internal Revenue Service of proposed or final determination of taxability or of a Notice of Proposed Issue (IRS Form 5701 TEB)	Unless described in the left-hand column, adverse tax opinions or other material notices or determinations by the Internal Revenue Service with respect to the tax status of the securities or other material events affecting the tax status of the securities
Principal and interest payment delinquencies	Modifications to rights of holders of the securities
Unscheduled draws on debt service reserves and credit enhancements reflecting financial difficulties	Optional, unscheduled or contingent Bond calls
Substitution of credit or liquidity providers, or their failure to perform	Release, substitution or sale of property securing repayment of the securities
Bond calls and tender offers	Non-payment related defaults
Defeasances	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
Rating Changes	Appointment of a successor or additional trustee or the change of name of a trustee
Bankruptcy, insolvency, receivership or similar event of the obligated person	Incurrence of a financial obligation or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the District, any of which affect bond holders
Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the issuer, any of which reflect financial difficulties	



