



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Julia H. Cooper

**SUBJECT: STUDY SESSION: ELECTED
OFFICIALS' ROLES AND
RESPONSIBILITIES IN
MUNICIPAL BOND DISCLOSURE**

DATE: March 13, 2023

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 Procedures¹ and advances the Debt Management Policy² 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

¹ Disclosure Policies and Procedures in City's Administrative Policy Manual - [CPM 7 Disclosures Policies and Procedures \(sanjoseca.gov\)](https://www.sanjoseca.gov/cpm/7-disclosures-policies-and-procedures)

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

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.³

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.

³ FY 2022 Comprehensive Annual Debt Report -

<https://www.sanjoseca.gov/home/showpublisheddocument/92714/638055795782970000>

HONORABLE MAYOR AND CITY COUNCIL

March 13, 2023

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

Page 3

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

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



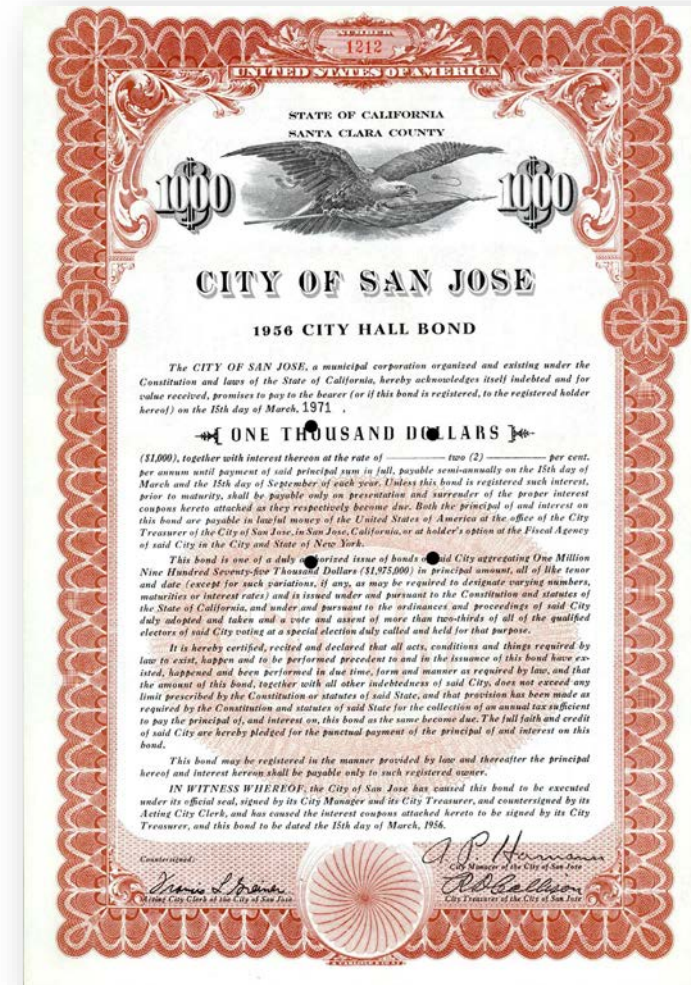
INTRODUCTION

- 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

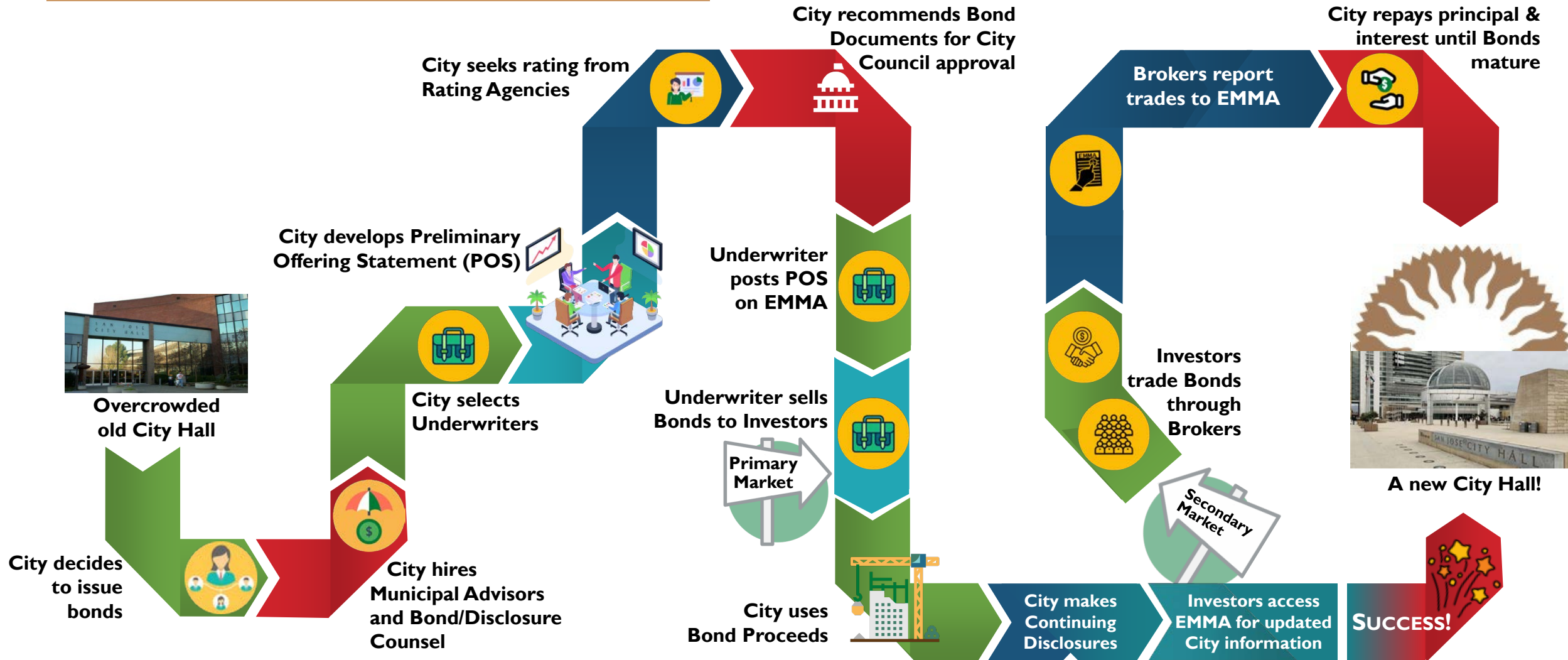


OVERVIEW OF MUNICIPAL BONDS

- 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 tax-exempt 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 not 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



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



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,

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But this year the Federal Reserve has been jacking up interest rates to clamp down on inflation. The rates at which Mr. Citron was forced to borrow rose above the return the fund could earn on long-term securities. The rate hikes sent the value of Mr. Citron's long-term bonds on a downward spiral: a prescription for bankruptcy. The fund appears to have lost more than 25 percent of its value.

It is a matter of detail which securities — 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.

Citron's risky strategy.

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 & Company.

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.



 VOICE of SAN DIEGO

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 years-long investigations into City Hall, which once appeared dormant, back into full view.

The New York 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

** 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 only 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”

* Debt Management Policy – Council Policy 1-15 <https://www.sanjoseca.gov/home/showpublisheddocument/12869/636669975466830000>

** 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



KEY PLAYERS IN BOND TRANSACTIONS

- **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



KEY PLAYERS IN BOND TRANSACTIONS

- **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



KEY PLAYERS IN BOND TRANSACTIONS

- **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



KEY PLAYERS IN BOND TRANSACTIONS

- **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
- **Disclosure Counsel** – 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



KEY PLAYERS IN BOND TRANSACTIONS

- **Trustee** – financial institution acts in a fiduciary capacity for the benefit of the bond owners including enforcement of the terms of the bonds
- **Underwriter/Purchaser** – 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	

