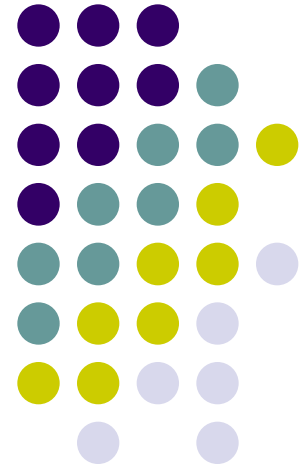


San Francisco Municipal Transportation Agency



Disclosure Responsibilities of Public Officials under Federal Securities Laws



The Wheels on the Bus . . .



- Presentation will cover the applicability of federal securities laws to board members when authorizing a bond sale
- What you will learn:
 - Applicable Securities Law
 - What's the Law
 - Official Statement
 - What is it
 - SFMTA's document
 - Discharge Your Duty
 - Questions to Ask
 - Oversight

Securities Law Overview



- Disclosure Contexts
- Disclosure Standards
- SEC and Private Litigation

SEC Jurisdiction in Municipal Securities Arena



- No securities registration
- Antifraud provisions apply
- Regulate municipal securities brokers and dealers (Rule 15c2-12)



Disclosure Contexts

- Primary
 - Preliminary and final Official Statements
- Secondary
 - Rule 15c2-12 Continuing Disclosure Agreements
 - Voluntary Filings
 - Investor Information Webpage
- Communications “reasonably expected to reach investors”



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 (cont.)



- Materiality

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

Litigation



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

SEC Enforcement Actions



- The governmental issuer
- Individual board members
- Governmental officials and employees
- Third parties (e.g., underwriters, financial advisors, bond counsel, disclosure counsel)



Important SEC Actions

- SEC actions which provide guidance about the duties of public officials when approving bonds:
- Orange County (1996)
- City of San Diego (2006)
- State of New Jersey (2010)

Orange County Report (1996)



- Nature of misleading disclosure:
concerned false and misleading statements in the offer and sale of over \$2.1 billion of municipal securities over 1993 and 1994 involving investment pool strategy, the risks of their investment strategy and investment results; Orange County's reliance on the investment results on the county's financial condition

Orange County Report (1996)



- “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 (1996)



- *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 (1996)



- “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.”

San Diego Report (2006)



- nature of misleading disclosure

“failed to disclose material information regarding substantial and growing liabilities for its pension plan and retiree health care and its ability to pay those obligations in the future”

San Diego Report (2006)



- where misleading disclosure occurred:
 - in the disclosure documents for its 2002 and 2003 offerings
 - in continuing disclosures filed in 2003
 - in presentations to the rating agencies



San Diego Report (2006)

- settlement only applies to the City, not City officials or Board members
- the SEC concluded that “[t]he City, through its officials, acted with scienter”
- meaning: “the City officials acted recklessly in failing to disclose material information regarding those liabilities [pension and retiree health]”

San Diego Report (2006)



- in 9th Circuit, recklessness is sufficient to find scienter
- violation of 17(a) of the 33 Act and Rule 10b-5 under the 34 Act

San Diego Report (2006)



- materiality of information:
 - City was intentionally under-funding its pension obligations
 - annual pension contributions expected to quadruple by FY '09
 - City would have difficulty funding its future annual pension contributions unless it obtained new revenues, reduced pension benefits, or reduced City services

San Diego Officials



- In a separate SEC settlement in October 2010, four former San Diego officials paid financial penalties
- First time SEC has secured financial penalties against City officials



New Jersey (2010)

- in San Diego, disclosure controls and training referred to as good remediation measures voluntarily undertaken
- in 2007 SEC speech, disclosure controls and training measures referred to as a critical lesson for municipalities

New Jersey – Disclosure Controls



- Nature of misleading disclosure:

“The State was aware of the under funding of [the pension systems] and the potential effects of the under funding. However, **due to a lack of disclosure training and inadequate procedures relating to the drafting and review of bond disclosure documents**, the State made material misrepresentations and failed to disclose material information regarding [the pension systems] in bond offering documents.”



Official Statement

- Bonds will be sold via official statement---a document prepared for potential investors (lenders); contains summary of the bond issue and material terms necessary for investors to make an informed investment decision

Official Statement (cont.)



- Guiding Principle: No misleading statements or omissions
- “Marketing” document versus pre-litigation defense
- It’s SFMTA’s disclosure document

Official Statement Observations

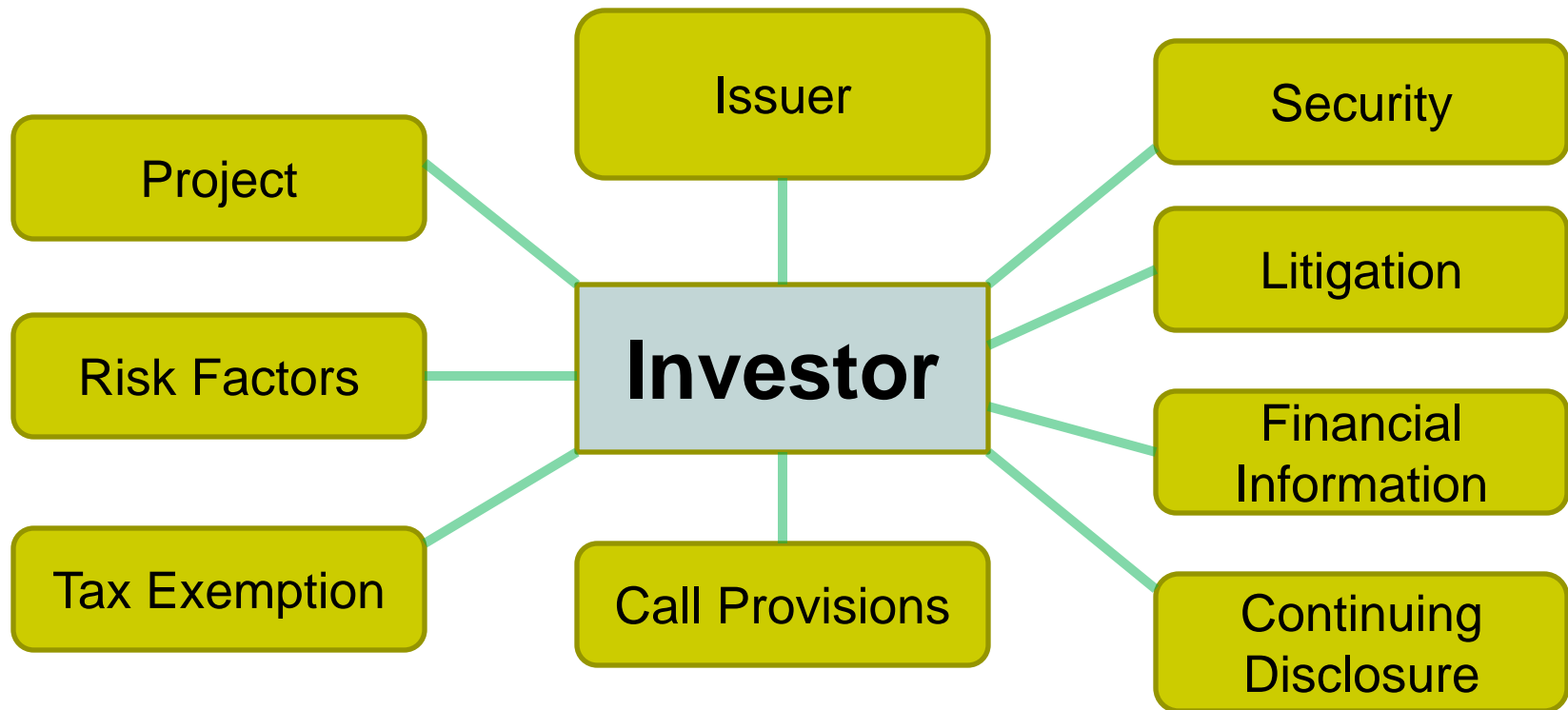


- **Observation 1:** Investors/SEC have exquisite *20/20 hindsight!*
- **Observation 2:** To disclose or not to disclose
- see observation 1
- SEC can impose civil penalties and make criminal referrals to DOJ



Official Statement (cont.)

Material information— “substantial likelihood a reasonable investor would consider it important to an investment decision.” See *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).





Discharging Your Duty

- Basic Inquiries:
- What is the purpose of the bond issue?
- What is the source of payment of the bonds?
- What are the risks that the source of payment may be insufficient to repay the bonds?
- Are there any factors that could pose a material risk to issuer's financial position?

Discharging Your Duty (cont.)



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

Discharging Your Duty (cont.)



- Have we 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?
- In reviewing the “relevant portions” of the OS, are there any “red flags” that should be brought to the attention of the financing team and/or for which I as a Board member would like a further explanation?

Oversight Questions



Can't I simply rely on staff and professionals?

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 finance professionals ?



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 for which I would like further explanation?

Summary



- Three contexts to disclosure
 - primary offerings
 - disclosure provided pursuant to Continuing Disclosure Agreements
 - any information reasonably expected to reach investors

Summary



- Standards
 - materiality
 - negligence, recklessness, intent

The End

