



North County Fire Protection District

Disclosure Responsibilities  
under the  
Federal Securities Laws

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# Why Is Disclosure Necessary?

- North County Fire Protection District issues securities in the public capital markets
- Investors in municipal securities have rights under federal securities laws
- All “material” information must be disclosed

# The Securities Act Of 1933

- 1933 Act has two substantive rules:
  - Registration requirement
  - Antifraud rule
- Municipal securities are exempt from the registration requirement, but are subject to antifraud rule
- Section 17(a)(2) prohibits any person from, directly or indirectly, obtaining money or property by means of any untrue statement of a material fact or by a misleading omission.

# Securities Exchange Act Of 1934

## Rule 10b-5

- Also contains antifraud provisions
- 1975 amendments to 1934 Act made it clear that antifraud provisions apply to government issuers

# Rule 10b5

“It shall be unlawful for any person . . .

- a) To employ any device, scheme or artifice to defraud,
- b) 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 . . . .”

# The “Materiality” Standard

- “[w]hether or not there is a substantial likelihood that a reasonable investor or prospective investor would consider the information important in deciding whether or not to invest.”
- Materiality is determined in context of all the facts and circumstances
- Guidance comes primarily from court decisions and SEC enforcement cases
- SEC has declined to provide advance guidance on materiality

# Levels Of Culpability

- Negligence – Failed to meet Prudent Person Test
- Recklessness – Ignored “red flags”
- Intent to defraud – Scinter

# When Do Disclosure Rules Apply?

- New offerings
- Annual Report under Rule 15c2-12
- Any other circumstance where an Issuer is “speaking to the market”
  - Applies to an official with responsibility for such disclosures
  - At this time, securities law does not impose a requirement to update or correct any statement previously made, if there is no other reason to be making a statement to the market



# Primary Offerings

- A sale of bonds to the public
- Official Statement is offering document to investors – equivalent to prospectus
- Must contain all material information for the particular bond sale
- Official Statement is North County Fire Protection District's document
- Underwriters, municipal advisors and lawyers can help develop the Official Statement but North County Fire Protection District is ultimately responsible for content

# Annual Reports

- Annual Reports are due as long as bonds are outstanding
- Includes Audited Financial Statements
- Includes Financial Information identified in Continuing Disclosure Agreement (Adopted Budget, specific tables from Official Statement)
- Consider Rule 10b5 implications – is there more you should be saying?
- When filing Annual Report ask if anything happened since the date of the audited financial reports that has materially impacted the District's financial condition?

# What Should Be Disclosed?

- Unlike corporate securities, there is no “line item” set of rules for what goes into an Official Statement
- Starting in 1975, leaders in municipal market created a set of Guidelines for Official Statement content
- Other groups have suggested disclosure for particular market segments
- Look at practices in the industry; recent SEC enforcement actions
- In the end, issuer must use its own good judgment

# Disclosure Process

- Seek input from key officials
- Fire Chief and Deputy Chief oversee and coordinate process
- Involve all key staff with relevant information
- Disclosure Counsel helps pull information together and produces a draft Preliminary Official Statement (“POS”)
- Draft POS reviewed by working group and revised prior to submission to Board

# Disclosure Process

- Board Members
  - Review key sections of POS related to District and its finances
  - Notify Fire Chief/Deputy Chief of any changes and questions prior to release of POS
- “Due diligence” meeting/call before distribution of POS
- Fire Chief or Deputy Chief deems POS final as of its date before release to investors

# Timing Considerations For Bond Sale

- Progression of an offering
  - POS
  - Bond Sale
  - Final OS
  - Closing
- Be mindful of timing of public actions or releases
  - State budget, District budget, budget updates
  - District financial information
  - Events related to pending litigation

# Disclosure Topics for Preliminary Official Statement

- Experience of District Management Team
- Tax base
- Pension Plans and OPEBs (GASB 68 and 75)
- Labor negotiations
- Source of District moneys
- Climate/weather issues
- Historical revenues, expenses and coverage
- Multi-year projections
- Capital Improvement Program
- Litigation and investigations
- Impact of State budget on District
- Information on debt – types and amounts

# Areas of Emphasis

- Possible impact of next economic downturn
- Status of fund balances and reserves
- Continuing disclosure compliance
- Pension and OPEB liabilities/impact of new assumptions and GASB standards
- Impact of COVID-19



# Disclosure Considerations

- Disclosure must evolve to reflect changing circumstances
- Read the disclosure with “fresh eyes”
- If you think something may be a concern, raise the issue with colleagues and the working group
- There are no “stupid questions”
- Political sensitivity and confidentiality considerations are not exceptions to disclosure

# S.E.C. Enforcement

- SEC enforcement actions are the primary vehicle to ensure compliance
- SEC has power to bring civil actions or refer to Justice Department for criminal action
- SEC has brought actions against municipal issuers, including individual officers, as well as other participants in the market, such as underwriters, lawyers, advisers, etc.

# Consequences of Bad Disclosure

- SEC Investigation – fees for lawyers and consultants
- Adverse publicity
- Reduced market access
- May have to impose new procedures and oversight to settle SEC actions

# What Can Go Wrong?

- Orange County – (Board approved Official Statement without review.)
  - Board that authorizes securities is responsible for disclosure
  - Reliance on professionals must be reasonable

“A public official who approves the issuance of securities and related disclosure documents may not authorize disclosure that the public official knows to be materially false or misleading; nor may the public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer’s ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts.”

# What Can Go Wrong? (cont)

- San Diego (Inaccurate disclosure on pension and retiree healthcare liability and errors in financial statements.)

- City commissions a review of its disclosure practices
- Conclusions from review:

“the City’s procedures, policies and practices for disclosure and financial reporting are inadequate in major respects. Undermining the reliability of its public disclosure have been, among other factors, the (1) the City’s excessive reliance on outside professionals to generate its disclosure documents, (2) its lack of procedures to verify the accuracy of those documents and (3) the absence of high-level oversight to judge the clarity and completeness of information provided to the investment markets.”

# What Can Go Wrong? (cont)

- State of New Jersey (State fails to disclose material information on two pension plans and specifically underfunding.)
  - Failure left investors unable to evaluate State's financial condition
  - State Treasurer did not read Official Statement
  - State Treasurer had no written policies or procedures relating to review or update
  - State Treasurer did not provide training concerning disclosure obligations

## What Can Go Wrong? (cont)

“Treasury had no written policies or procedures relating to the review or update of the bond offering documents. In addition, Treasury did not provide training to its employees concerning the State’s disclosure obligations under the accounting standards or the federal securities laws. Accordingly, the State’s procedures were inadequate for ensuring that material information concerning [the pension plans] or the State’s financing of [the pension plans] was disclosed and accurate in bond offering documents.”

## What Can Go Wrong? (cont)

- West Clark Community Schools District (Indiana) – (fraudulent misstatement in a 2007 Official Statement that it was in compliance with its disclosure obligations related to prior bond offerings.)
- The district had not submitted any of the required annual reports or notices for a previous 2005 bond offering, and the underwriter did not conduct adequate due diligence with respect to continuing disclosure compliance.



# What Can Go Wrong? (cont)

- State of Illinois – (Omission of material information relating to the unfunded liabilities of its pension system.)

# What Can Go Wrong? (cont)

- City of South Miami (Florida) – (**Material misstatements related to the City's compliance with various tax requirements for the bonds.**)

# What Can Go Wrong? (cont)

- City of Allen Park (Michigan) – The SEC found that City bond offering documents **used outdated budget information** in offering documents that failed to disclose a known budget deficit of at least \$2 million.

## Allen Park - Settlement with the City:

- The City agreed to cease and desist from future securities law violation. No fines were levied against the City, but the City agreed **to adopt written policies and procedures**, to disclose the cease and desist order in any offering in the next two years and to **undertake disclosure training**.

# What Can Go Wrong? (cont)

Allen Park - Settlement with the City Administrator and Mayor:

- The City Administrator entered into settlement agreement, which included an order not to violate the federal securities laws in the future and **not to participate in an offering of municipal securities in the future**, but no payment of a fine.
- The Mayor entered into a settlement agreement, which included an order not to violate the federal securities laws in the future, not to participate in an offering of municipal securities and **payment of a \$10,000 fine**.

# What Can Go Wrong? (cont)

- Westlands Water District – The SEC found that the Water District bond official statement contained misleading debt service coverage ratio information due to failure to disclose (1) extraordinary accounting transactions and (2) a later adjustment to prior year expenses.
- Westlands Water District – Settlement:
  - SEC’s cease and desist order found violation of Section 17(a)(2) of the Securities Act.
  - District ordered to **pay \$125,000.**
  - General Manager ordered to **pay \$50,000 from personal funds.**
  - Assistant General Manager ordered to **pay \$20,000 from personal funds.**

# Summary of Recommended Actions

- Schedule periodic training
- Review policies and procedures from time to time
- Make sure that responsible officials are familiar with disclosure
- Review the entire POS
- Seek information and ask questions of the officials, employees and professionals who supplied information to be included in the POS
- Ask follow up questions to determine the reasonableness of any assumptions or estimates that were used in the POS