

General Securities Law

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The Essentials

APRIL 19–21, 2023

Introduction – What we will cover?

1933 Act – Registration Requirements and Exemptions

Trust Indenture Act of 1939

Anti-Fraud Provisions

Common Law Causes of Action

SEC Rule 15c2-12

SEC Enforcement

MSRB and Rules

State Blue Sky Laws

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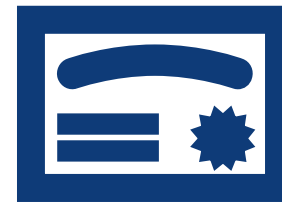
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1933 Act Registration Requirement



Unless exempted, Section 5 of the 1933 Act requires a registration statement be filed with the SEC before selling securities



“Security” is broadly defined (includes bonds, notes, certificates of participation, guaranteed investment contracts, letters of credit, surety bonds, leases, loan agreements, etc.)

Exemptions From Registration Under 1933 Act

Exempt Securities – Section 3

- **Section 3(a)(2)** – issued or guaranteed by U.S. or any territory thereof, any state, political subdivision or public instrumentality thereof, a national or state bank and certain IDBs (as defined in 1954 Code)
- **Section 3(a)(4)** – 501(c)(3) securities
- **Section 3(a)(8)** – Insurance policies
- **Section 3(a)(11)** – Intrastate offerings
- **Rule 131** – Separate security doctrine

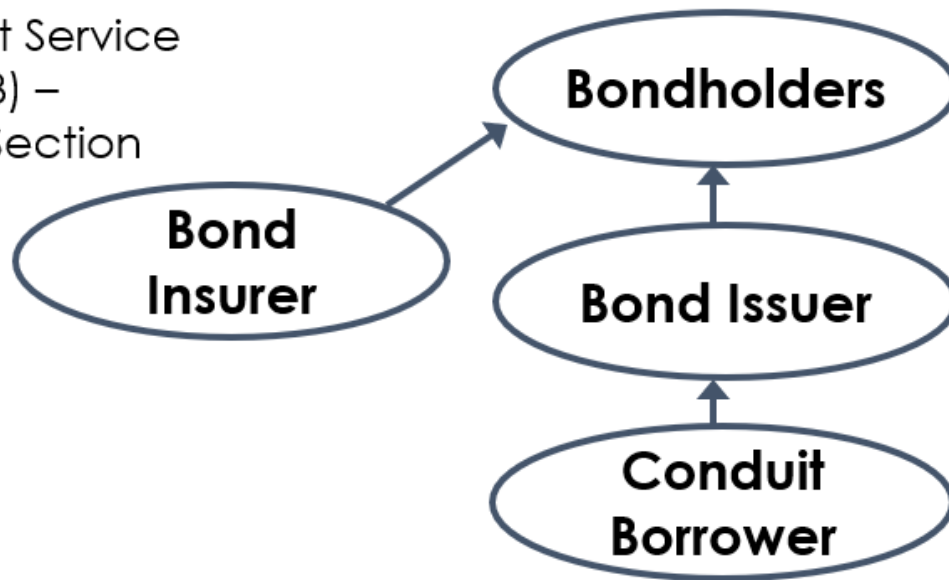
Exempt Transactions – Section 4

- **Section 4(a)(6)** – “accredited investors” only and less than \$5 million
- **Section 4(a)(2)** – not a “public offering” (Regulation D as safe harbor)
- **Section 4(a)(1)** – transactions by persons other than an issuer, underwriter or dealer
- **Section 4(a)(3)** – transactions by a dealer (not as an underwriter)
- **Rule 144 and 144A** (“qualified institutional buyers” only) safe harbors

A Municipal Offering May Have Multiple Securities –

But Also Multiple Exemptions From Registration

Guaranty of Debt Service
(Security #3) –
Exempt under Section
3(a)(8)?



Bond
(Security #1) –
Exempt under Section
3(a)(2)?

Loan/Lease
(Security #2) –
Exempt under Section
3(a)(2) or Section 3(a)(4)?
Rule 131?

Trust Indenture Act of 1939

Indentures under which securities are issued must be qualified by the SEC, unless an exemption is available

Indenture is broadly defined

Indentures of exempt securities exempt from all Indenture Act requirements

Exempt transactions exempt from qualification requirement

Antifraud Provisions – Overview

Municipal securities exempt from registration are not exempt from the antifraud provisions

- Section 17(a) of 1933 Act
- Section 10(b) of 1934 Act/Rule 10b-5

Objectives of 1933 Act and 1934 Act

- Disclosure of material information to allow investors to make informed decisions
- Prohibit misrepresentation or other fraudulent conduct in connection with the purchase or sale of securities

Anti-fraud provisions apply in three main contexts:

- Primary disclosure (e.g. Official Statement)
- Secondary market disclosure (required or voluntary filings on EMMA)
- “when it releases information to the public that is reasonably expected to reach investors and the trading markets” – Exchange Act Release 34-33741 (March 9, 1994) (Interpretive Release); Staff Legal Bulletin No. 21 (OMS) (Feb. 7, 2020)

Section 17(a) of the 1933 Act

In “offer or sale” of securities, unlawful to use interstate commerce or the mails –

1. To employ any device, scheme or artifice to defraud;
2. To obtain money or property by means of any material misstatement or omission; or
3. To engage in any transaction, practice or course of business operating as a fraud or deceit upon the purchaser
4. No private right of action
5. Intent or negligence is sufficient for violation
 - no finding of scienter (intent to defraud) is required
 - “knew or should have known” standard for establishing negligence
 - Failure by an actor to conform conduct to the standard of a reasonable person under like circumstances

Section 10(b) of 1934 Act/Rule 10b-5

- Section 10(b) prohibits the use, in connection with *purchase or sale* of a security, of “any manipulative or deceptive device”
- Rule 10b-5 – prohibits use of interstate commerce, mails or national securities exchange -
 - To employ any device, scheme or artifice to defraud;
 - To make any material misstatement or omission; or
 - To engage in any fraud or deceit
- Courts recognize private causes of action (need reliance and damage)
- For 10b-5 violation, SEC must show there was intent to defraud (scienter)
 - Recklessness (highly unreasonable conduct that is an extreme departure from standards of ordinary care) is sufficient to establish scienter
 - Danger need not be known
 - Must be so obvious any reasonable person would have known of it

Materiality?

Case law defines materiality:

There is a substantial likelihood

That a reasonable bond investor

Would consider it important in making an investment decision

There must be a substantial likelihood a fact *"would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."*

In sum: all communications to investors must be true, accurate and complete

Secondary Liability under Antifraud Provisions

Extension of 17(a) and 10(b) liability to parties not directly involved in securities offering

Aiding and abetting elements

- Existence of primary violation
- Defendant's knowledge or duty of inquiry as to primary violation
- Substantial assistance to primary violation

1994 Central Bank decision – no private cause of action for aiding and abetting

1995 amendments – SEC and federal prosecutors may bring actions under 10(b)

Dodd – Frank Act – Loosen scienter standard to include recklessness (not just knowing conduct) for aiding and abetting

Common Law Causes of Action

- **Fraud and deceit – action for money damages**

- False representation
- Materiality
- Misstatement of fact
- Scier (knowledge/recklessness of falsity)
- Reliance (only private actions)
- Damages (only private actions)

- **Rescission**

- Misrepresentation
- Materiality
- Facts
- Reliance
- Not required to show scier, causation or damages

SEC Rule 15c2-12 (the “Rule”)

Promulgated in 1989, following Washington Public Power Supply System (“WPPSS”) – the largest municipal bond default in U.S. history to that date, amended in 1994 to add continuing disclosure, and amended in 2008, 2010 and 2018 to modify certain continuing disclosure provisions

Directly governs underwriters; indirectly governs issuers/obligors of bonds
(Tower Amendment)

Not an antifraud rule; but disclosures made under the Rule are subject to the antifraud rules

Designed to ensure market transparency by making material information available to the public and investors

Applies to primary offerings of municipal securities with a principal amount of \$1 million or more, and certain remarketings involving changes in authorized denomination or tender period

Primary Disclosure Requirements of Rule 15c2-12

- Review of Deemed Final Official Statement (“OS”)
 - Participating underwriter must *obtain* and *review* prior to bidding for, purchasing, offering or selling municipal securities
 - Issuer (including any conduit borrower) must deem final
 - Pricing information and other permitted omissions
 - May be combination of documents
- Dissemination to potential customers
 - POS
 - OS – until “end of underwriting period” – implied duty to update
- Contract to receive final OS
- Final Official Statement is defined in the Rule
- An issuer has an affirmative obligation to know the contents of its OS, including the financial statements

Ongoing Disclosure Requirements of Rule 15c2-12

Participating underwriter must reasonably determine that issuer and/or obligated persons have undertaken in writing to provide continuing disclosure

- Can be through ordinance, resolution, loan agreement, trust indenture, separate ongoing disclosure certificate/agreement

Obligated persons

- Any person committed by contract or other arrangement to support payment of all or part of security
- Excludes bond insurers and letter of credit or liquidity providers

Rule 15c2-12 Continuing Disclosure Requirements

Scope of Continuing Disclosure Undertaking

- Annual financial information
- Audited financial statements
- Notice of certain listed events
- Can contractually commit to provide more information than is required by the Rule
- Note that under the Rule a “Final Official statement” must provide
 - scope of undertaking, and
 - summary of prior failures, within the past five years, to comply, in all material respects, with prior continuing disclosure undertakings

Listed Events under the Rule

To be reported within 10 business days of the occurrence of the event

- (1) Principal and interest payment delinquencies;
- (2) Non-payment related defaults, if material;
- (3) Unscheduled draws on debt service reserves reflecting financial difficulties;
- (4) Unscheduled draws on credit enhancements reflecting financial difficulties;
- (5) Substitution of credit or liquidity providers, or their failure to perform;
- (6) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security;
- (7) Modifications to rights of security holders, if material;
- (8) Bond calls, if material, and tender offers;
- (9) Defeasances;
- (10) Release, substitution, or sale of property securing repayment of the securities, if material;

- (11) Rating changes;
- (12) Bankruptcy, insolvency, receivership or similar event of the obligated person;
- (13) 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, if material;
- (14) Appointment of a successor or additional trustee or the change of name of a trustee, if material;
- (15) Incurrence of: (i) a financial obligation of the obligated person, if material, or (ii) agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person any of which affect security holders, if material;
- (16) Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties;

Rule 15c2-12 Continuing Disclosure Requirements – “Financial Obligation”

- **“Financial Obligation” means: (i) a debt obligation; (ii) a derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (iii) a guarantee of (i) or (ii).**
 - It does not include ordinary financial and operating liabilities incurred in the normal course of business, only debt, debt-like, and debt- related obligations.
 - It does not include municipal securities as to which a final official statement has been provided to the MSRB “consistent with the Rule,” (but does include any associated financial obligations such as a derivative instrument entered into in connection with the municipal securities)
- **Factors to consider when assessing whether a financial obligation is material, include:**
 - remedies,
 - other similar terms that affect security holders to which the issuer or obligated person agreed at the time of incurrence,
 - size of the overall balance sheet,
 - size of existing obligations, and
 - size of the overall bond portfolio.
 - source of security pledged for repayment of the financial obligation,
 - rights associated with such a pledge (e.g., senior versus subordinate),
 - principal amount or notional amount (in the case of a derivative instrument or guarantee of a derivative instrument),
 - covenants,
 - events of default,

Rule 15c2-12 Continuing Disclosure Requirements – Two New Listed Events (cont'd)

A default could be a monetary default, where an issuer or obligated person fails to pay principal, interest, or other funds due, or a non-payment related default, where an issuer or obligated person fails to comply with specified covenants.

There are defaults that may reflect financial difficulties even if they do not qualify as “events of defaults” under transaction documents.

Exemptions from Rule 15c2-12

- **Limited placement exemption**
 - \$100,000 denominations
 - 35 or fewer knowledgeable/experienced investors
- **Short-term debt exemption**
 - \$100,000 denominations
 - Maturity 9 months or less (VRDOs now subject to continuing disclosure requirements but not primary offering requirements)
- **Limited exemption for continuing disclosure**
 - Obligated person of no more than \$10 million
 - Effective July 1, 2009, this limitation changed
 - Under \$10 million issuers are now subject to the material events notice requirements and required to provide financial information and operating data that is “customarily prepared by the municipality and is publicly available”
- **Limited exemption from annual reporting for municipal securities having maturity 18 months or less**

Rule 15c2-12 – Process – Where to File?

Dissemination of Information – Prior Process

- NRMSIRs
- SIDs

Now, annual financial information and any material event notices must be submitted in an electronic format to the MSRB through its web-based system known as **EMMA**.

- Became effective July 1, 2009.
- MSRB has been designated as the sole NRMSIR for bonds issued after July 1, 2009.
- Does not automatically include filings made prior to July 1, 2009 with then-existing NRMSIRs.

SEC Enforcement

SEC Trend of Enforcement

- Before 2007 financial crisis – SEC was less focused on municipal securities
- Steps have been taken since (e.g. Dodd Frank, MCDC, etc.) whereby SEC has increased its scrutiny on municipal market

SEC investigations – formal or informal

May be followed by Enforcement Action

- Administrative proceedings
 - monetary penalties
 - remedial sanctions
 - cease and desist orders
- Civil proceedings in federal district court
- Criminal actions referred to DOJ
- Referrals to other federal, state or self-regulatory authorities
- Delivery of 21(a) reports

SEC Enforcement (cont'd)

Municipal Securities Enforcement Actions Illustrate

- Disclosure responsibilities of issuer and authorizing officials
- Limited ability of issuers to rely on staff and third-parties (consultants, attorneys) in drafting and reviewing of disclosure
- Responsibilities of underwriters
- Responsibilities of third parties
- Applicability and interpretation of “materiality” standard
- No financial harm is required
- Following written policies and procedures can help show reasonable care

SEC Enforcement Recent Trends

SEC Charges PNC Capital Markets LLC for Violating Municipal Bond Disclosure Law (December 21, 2022)

SEC Charges Four Investment Advisers for Pay-To-Play Violations Involving Campaign Contributions (September 15, 2022)

SEC Charges Loop Capital Markets in First Action against Broker-Dealer for Violating Municipal Advisor Registration Rule (September 14, 2022)

SEC Charges Four Underwriters in First Actions Enforcing Municipal Bond Disclosure Law (September 13, 2022)

SEC Charges Municipal Advisor and Broker to Charter Schools With Failing to Register With The Commission (September 9, 2022)

SEC Charges Former Texas City Official for Falsifying City's Financial Documents (June 16, 2022)

SEC Charges Rochester, NY, and City's Former Executives and Municipal Advisor with Misleading Investors (June 14, 2022)

SEC Charges Louisiana Town and Former Mayor with Fraud in Two Municipal Bond Deals (June 2, 2022)

SEC Charges Texas School District and its Former CFO with Fraud in \$20 Million Bond Sale (March 16, 2022)

SEC Charges Firm and Two Principals in First-Ever Actions Enforcing Rule on Duties of Municipal Advisors (September 23, 2021)

RBC Charged With Failing to Give Priority to Retail and Institutional Investors in Municipal Offerings (September 17, 2021)

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SEC Enforcement Recent Trends

SEC Charges School District and Former Executive with Misleading Investors in Bond Offering (September 16, 2021)

SEC Charges Former Municipal Bond Salesperson with Fraud (August 31, 2021)

SEC Charges Underwriter and Its Former CEO With Misconduct In Muni Bond Tender Offer (August 26, 2021)

SEC Charges Hilltop Securities and Trader for Misconduct in Municipal Offerings (July 9, 2021)

SEC Charges Two Former KPMG Auditors for Improper Professional Conduct During Audit of Not-for-Profit College (February 23, 2021)

SEC Charges First Midstate, Inc. and Owner Paul D. Brown with Unfair Conduct in Connection with Municipal Underwritings (December 22, 2020)

SEC Charges Charter School Municipal Advisor with Failing to Register with the Commission (September 25, 2020)

SEC Charges Former Jefferies Registered Representative for Improper Retail Orders in Municipal Bond Offerings (September 22, 2020)

SEC Charges Charter School Operator and its Former President With Fraudulent Municipal Bond Offering (September 14, 2020)

SEC Charges Roosevelt & Cross and Two of Its Salespeople for Retail Order Period Misconduct in Municipal Offerings (September 14, 2020)

UBS to Pay \$10 Million for Violating Rules Which Give Priority To Retail Investors in Municipal Offerings (July 20, 2020)

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SEC Enforcement Recent Trends

SEC Charges Two California Charter School Officials with Misleading Investors in Bond Offering (April 27, 2020)

In the Matter of Boenning & Scattergood Inc., Craig Burdulis and Brian Gillespie (April 16, 2020)

SEC Obtains Final Judgments in Pay-To-Play Scheme (December 26, 2019)

SEC Charges Los Angeles County School District and Two Officials with Defrauding Investors in \$100 Million Bond Offering (September 19, 2019)

SEC Charges Morgan Stanley for Recommending Unsuitable Municipal Bond Transactions (September 17, 2019)

SEC Charges Former Municipal Bond Trader in Fraudulent Retail Order Scheme (September 3, 2019)

Municipal Advisor and Solicitors Charged with Registration Violations (July, 16, 2019)

SEC Charges Municipal Advisor with Breaching Fiduciary Duty (June 27, 2019)

In the Matter of IFS Securities (June 27, 2019)

Town of Oyster Bay, New York, Agrees to Settle SEC Charges (June 7, 2019)

In the Matter of Clear Scope Advisors, Inc. (April 11, 2019)

SEC Charges College Official for Fraudulently Concealing Financial Troubles From Municipal Bond Investors (Mar. 28, 2019)

Court Penalizes Wells Fargo Securities for Disclosure Failures in 38 Studios Bond Offering (Mar. 20, 2019)

SEC Charges Former Municipal Officer with Fraud in Connection with Public Pension Funds (Mar. 15, 2019)

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Other SEC Activity

Staff Legal Bulletin 21 (February 2020)

- In February 2020, the Staff of the Office of Municipal Securities issued Legal Bulletin 21 summarizing existing law regarding the application of the antifraud requirements to public statements by issuers and borrowers.
- Focuses on the scienter standard and the total mix of information that affects whether a statement is material.
- The “antifraud provisions [of Section 10(b) and Rule 10b-5] apply to the purchase and sale of municipal securities in the secondary market, including to statements made by municipal issuers that are reasonably expected to reach investors and trading markets.”

Statement on COVID-19 Disclosure

- May 2020 statements of SEC Chair and Director of the SEC Office of Municipal Securities encourages voluntary disclosure of COVID-19 impacts and seeks to provide some assurances to issuers and borrowers.
- Note corporate matter re The Cheesecake Factory (Release No. 2020-306 (Dec. 4, 2020))

Disclosure Conferences and MA Compliance Outreach Events

MSRB

Self-regulatory organization

Relationship with the SEC

Relationship with FINRA

Relationship with Financial Entities and Municipal Advisors

Dodd-Frank Wall Street Reform and Consumer Protection Act altered MSRB governance structure and expanded MSRB powers

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MSRB (cont'd)

Some Key Rules

- Rule G-11 - Primary Offering Practices
- Rule G-17 - Fair Dealing Rule
- Rule G-19 - Suitability; Discretionary Accounts
- Rule G-18 – Best Execution
- Rule G-20 - Gifts, Gratuities and Non-Cash Compensation
- Rule G-23 - Activities of Financial Advisors
- Rule G-27 - Supervision
- Rule G-30 - Prices and Commissions
- Rule G-32 - Delivery of Final OS
- Rule G-34 - CUSIP numbers, New Issue and Market Information Requirements (including certain information related to auction rate securities and VRDO's)
- Rule G-37 - Political Contributions
- Rule G-38 - Disclosure of Consultants
- Rule G-42 – Duties of Non-Solicitor Municipal Advisors
- Rule G-43 - Broker's Brokers
- Rule G-44: Supervisory and Compliance Obligations of Municipal Advisors
- Rule G-48 – Transactions with sophisticated professionals

State Blue Sky Laws

Anti-fraud state laws requiring registration of securities offerings and sales.

State Securities Laws

- Uniform act is basis for many states' laws
- However, many exceptions and distinctions

Blue Sky Memoranda – distributed to underwriters with Preliminary Official Statement

- Exempt securities – states where type of security is exempt from registration
- Exempt transaction – entities to whom sales are exempt – generally sophisticated institutional purchasers
- Typically prepared by underwriter's counsel

1996 NSMIA

- Limits states' authority with respect to "covered securities"
- Securities laws of the state of issuance still apply
- State laws requiring notice filings and fees permitted – and must be complied with by final OS posting

Questions

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