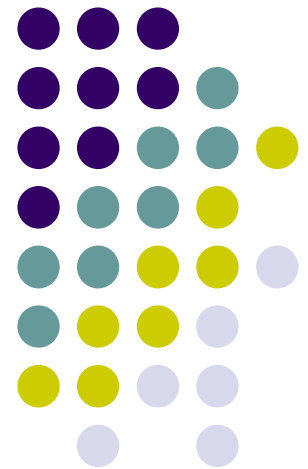




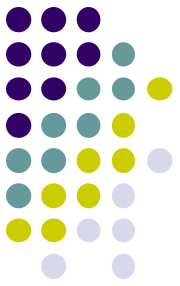
San Francisco Municipal Transportation Agency

Responsibilities of SFMTA Board of Directors under Federal Securities Laws When Approving Bond Official Statements



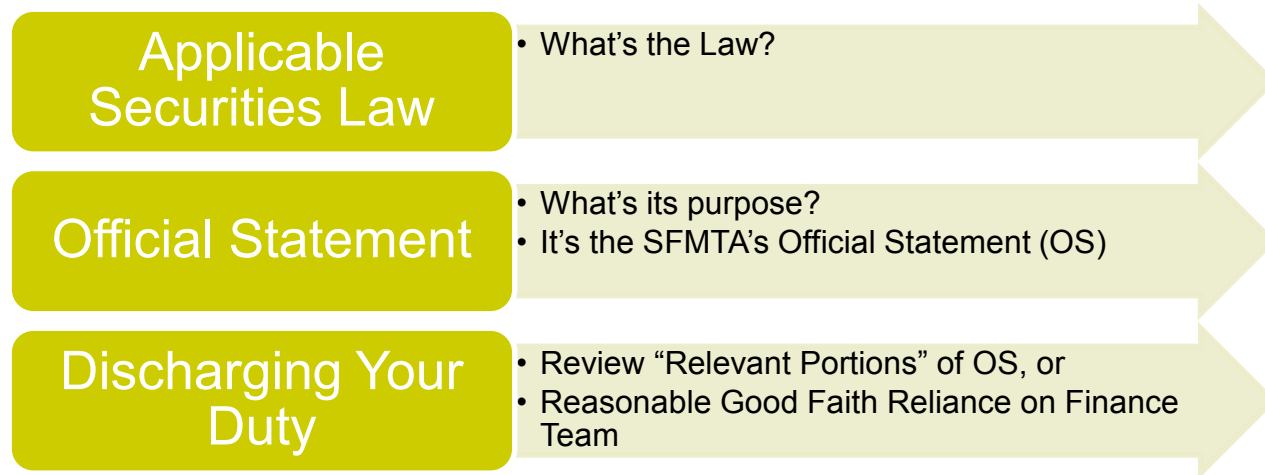
Mark D. Blake
Deputy City Attorney

January 15, 2019



Introduction

- Presentation will cover applicability of federal securities laws to SFMTA Board of Directors when authorizing a bond sale, including:



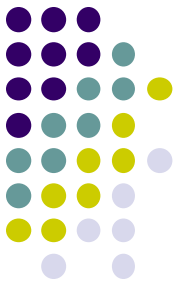
SEC Does Not Directly Regulate Municipal Securities



- No direct regulation by Securities and Exchange Commission (“SEC”)
- *But, SEC indirectly regulates municipal securities through direct regulation of brokers/dealers (Rule 15c2-12), and municipal financial advisors*
- *And, SEC enforces market discipline through application of “antifraud” provisions of security laws to ensure efficient/fair market*

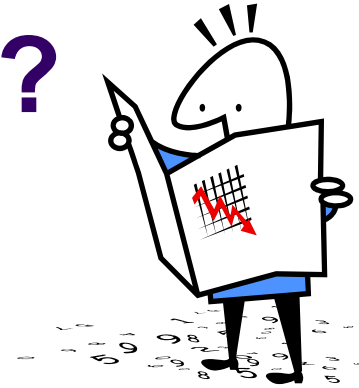
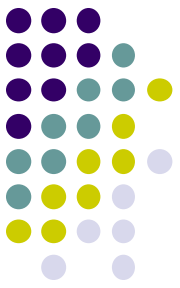


SEC Observations Re Municipal Securities Practice

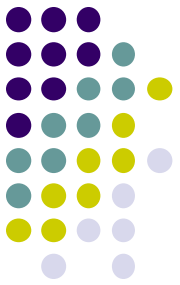


- **SEC has noted sources of problems for issuers:**
 - **Training:** individuals involved in the disclosure process should be periodically trained to ensure that they understand their responsibilities under the federal securities laws.
 - **“Silo” Effect:** where departments within an issuer do not effectively communicate with each other to ensure that their disclosure documents tell an accurate and complete story to investors.
 - **Lack of controls and procedures:** SEC believes that too many issuers in the market do not have a careful processes to ensure that their disclosure documents are accurate and complete, and that personnel are accountable in process.
 - **Concerned about political influence:** several of the SEC actions involve direct or indirect influence of political considerations that had the effect of distorting the content of disclosure provided to investors.

WHEN DO SECURITIES LAWS ATTACH?



- Primary Market Offerings
 - Preliminary and final Official Statements
- Communications “reasonably expected to reach investors”
 - Example: Public official comments “Invest in SFMTA bonds. 100% safe. You can’t lose!”



Disclosure Standard

- Antifraud provisions of Federal securities laws make it unlawful to make untrue statements of ***material*** fact or omissions in the offer and sale of municipal bonds.
 - For municipal issuers, SEC would need to prove issuer was negligent
 - Antifraud provisions intended to address informational asymmetry between issuers and investors



Disclosure Standard (cont.)

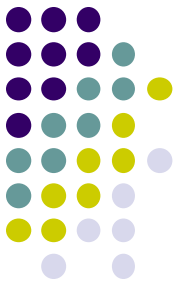


- What is ‘material’?

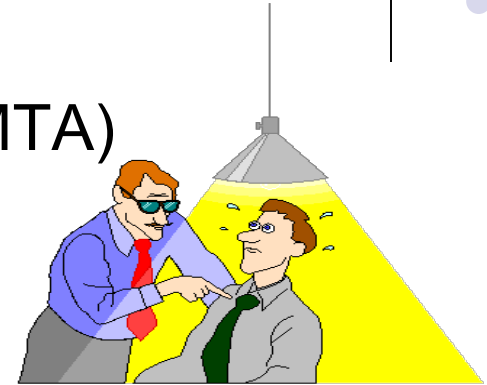
“substantial likelihood that, under all the circumstances, the [misleading or] omitted **fact** would have assumed actual significance in the deliberations of the reasonable [investor].”

- Facts and circumstances determination
- Puffery, opinions, forward looking statements

SEC Enforcement Actions



- The governmental issuer (i.e., the SFMTA)
- Individual board/commission members
 - To date, no member of a legislative body has been sanctioned by the SEC
- Governmental officials and employees
- Third parties (e.g., underwriters, financial advisors, bond counsel, disclosure counsel)





Guidance for Commissioners

- Potential liability of SFMTA for materially misleading disclosure arises in three contexts
 - Official Statements---Primary Market
 - filings with Electronic Municipal Market Access (“EMMA”) portal (contractual and voluntary)
 - communications “reasonably expected to reach investors”
- But SEC guidance for Board/Commission Members limited to Official Statements
 - Orange County Report

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 County investment pool; resulted in then largest municipal bankruptcy in US history . . .

- Orange County official statements failed to disclose reliance on investment results for County's financial condition and risks of investment strategy

Orange County Report (1996)



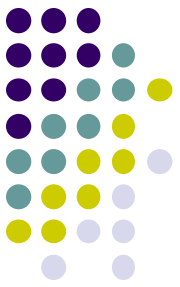
- Orange County SEC's 21(a) Report:

“Despite their knowledge of the County's increasing use of interest income from the County Pools to balance the discretionary budget, the Supervisors approved the Official Statements...without taking steps to assure disclosure of this information. They never received or asked to receive a copy of any Preliminary Official Statement once finalized, or any final Official Statement; nor did they question the County's officials, employees or other agents concerning the disclosure regarding the County's financial condition.”



Orange County Report (1996)

Bright Line Rules!



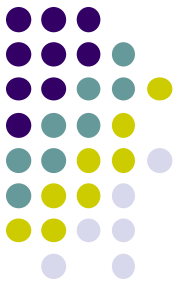
- “a public official may not authorize disclosure that the official knows to be false”
- “nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading”



Orange County Report (1996)

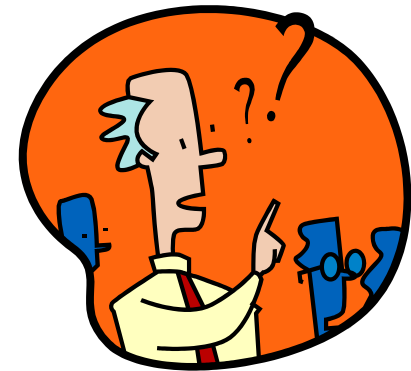


- *What is “acting recklessly”?*
 - public official has knowledge of facts bringing into question the issuer’s ability to repay the securities
 - fails to take steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts

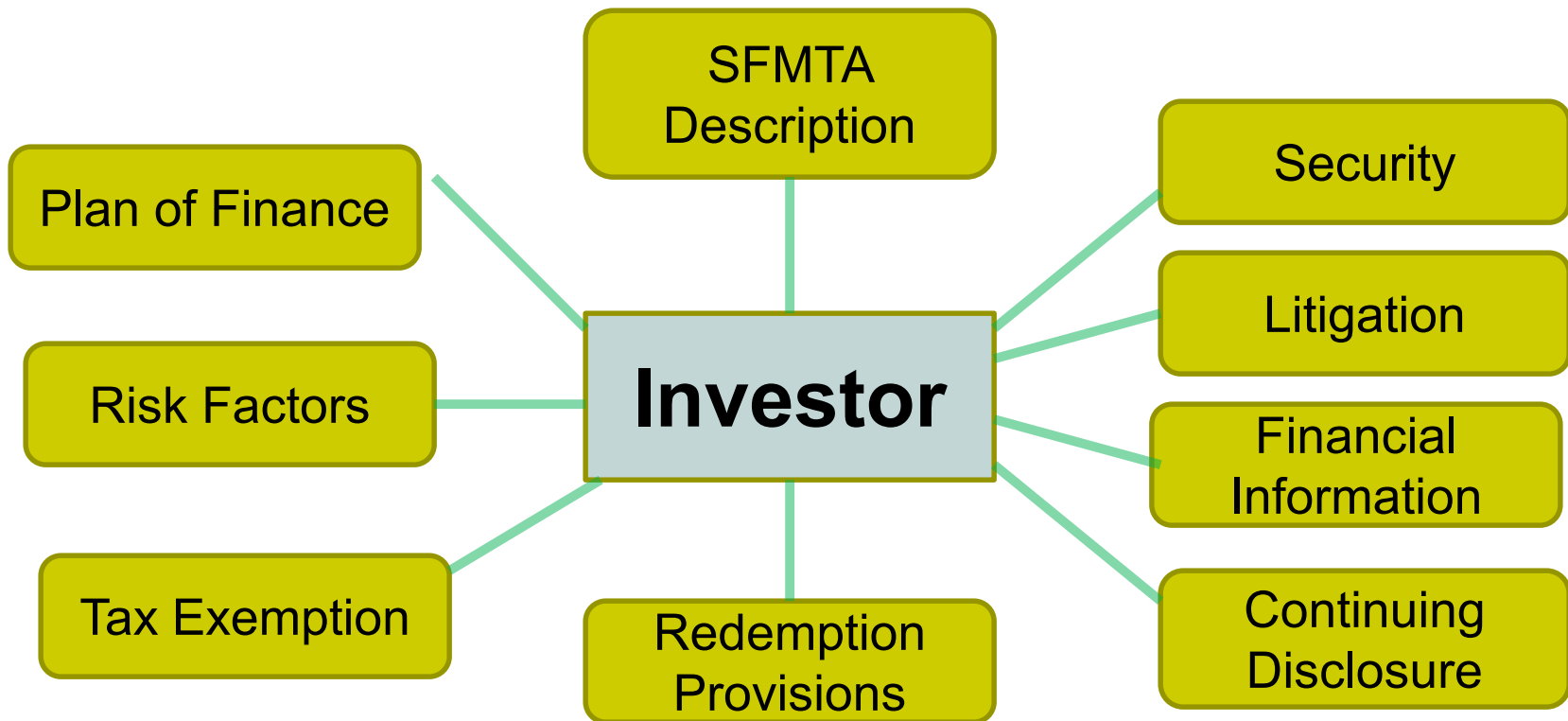
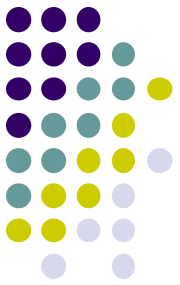


Orange County Report (1996)

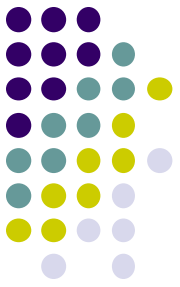
- “such steps could have included becoming familiar with the disclosure documents and questioning the issuer’s officials, employees or other agents about the disclosure of those facts.”



Official Statement

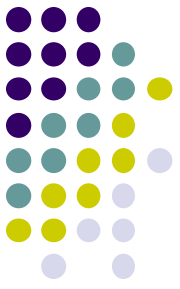


SFMTA's Official Statement Must Tell Whole Credit Story



- ***It's the SFMTA's Official Statement!***
- ***SFMTA's Official Statement should . . .***
 - provide investors clear information they need to make a informed investment decision
 - describe SFMTA's challenges as well as SFMTA's successes
 - consider investor's perspective---concept of materiality---why is this fact important to know?
- ***Why is this so important?***
 - telling whole bond credit story is core of the requirement of the Federal antifraud laws---it's the law!!
 - SFMTA's reputation as a truthful arbiter of the facts will, arguably, lower interest costs that investors charge . . .

Themes in Official Statement Training



Take care---be deliberate—be critical

Make sure that appropriate individuals are included in the process

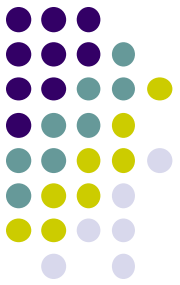
- Make sure that the information used to prepare the official statement comes from appropriate sources
- Make sure experts review disclosure that relates to their expertise
- Make sure people in proper authority review the disclosure
- ***Empower people to raise questions!!***

Communication is Key; Avoid Information Silos

- Disclosure Must tell Whole Credit Story

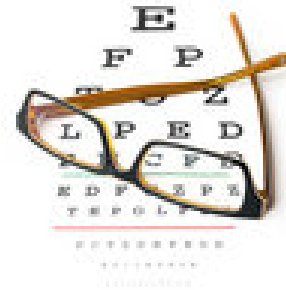
Be sure everyone is trained and knowledgeable

Official Statement Observations



- **Observation 1:** Investors/SEC have 20/20 *hindsight!*

- **Observation 2:** To disclose or not?
See observation 1, and disclose.



- SEC can impose civil penalties and make criminal referrals to Department of Justice

Controls and Procedures: A Must Have!



- ***Why important?*** SEC believes controls and procedures ensure the right people are involved and accountable, assist with careful and critical disclosure, and helps issuers focus on what is important to investors and provide investors the information they need
- California law now requires issuers to adopt debt policies (SB 1029, Hertzberg) (effective January 1, 2017)
- ***Good disclosure policies and procedures:***
 - Identify who is responsible for what
 - Ensure right people are involved/accountable
 - Require disclosure training for all involved in bond process
- ***SFMTA has adopted disclosure policies and procedures.***

Why Board of Directors Securities Law Training?



- minimize risk of misleading disclosure
- defend against charge of negligence or recklessness



Official Statement Consideration

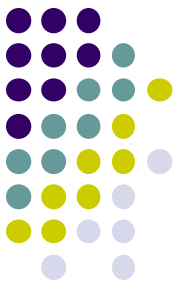


How to Discharge Legal Responsibilities?

- Read ‘relevant portions’ of Official Statement
 - if there are material adverse financial trends of which you are aware (or objectively should have been aware), issuer should reasonably investigate that trend, or
- Ensure that reliance on SFMTA’s staff is reasonable, and in good faith



Questions to Consider Prior to Official Statement Approval



Basic Inquiries:

- What is purpose of bond issue?
- What is source of payment of bonds?
- What are risks that sources of repayment may be insufficient?
- What are key factors that pose a material risk to issuer's financial position?



Official Statement Approval (cont.)



- Do I have knowledge of any other events that could affect deliberations 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?

Official Statement Approval (cont.)



- Will we provide continuing disclosure for bonds, and if so, what are the procedures for preparing and distributing the information?
- Have you seen any “red flags” in the Official Statement that should be brought to attention of SFMTA finance staff/city attorney for which I, as a SFMTA Board of Director, would like a further explanation?



Reliance on Staff

Can't I simply rely on staff and professionals? Answer:

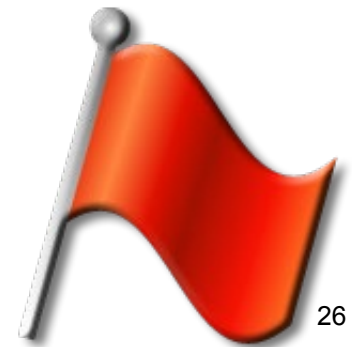
Yes, but . . .

1. Do we have written disclosure controls and procedures? If so, have procedures been followed in preparing the disclosure document?
2. Do I have a reasonable basis to believe in the integrity and competence of finance professionals?

Reliance on Staff (cont.)



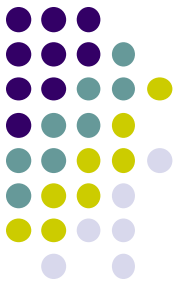
3. Do I know anything that would cause me to question the accuracy of the disclosure or that would indicate that there is a risk that those disclosures may be misleading?
4. With reference to the disclosure documents, do I know of any potentially material issues or “red flags” that should be brought to the attention of management or for which I would like further explanation?



SFMTA's Disclosure Controls



- The SFMTA has strong internal controls to mitigate against potential of misleading disclosure:
 - Written Disclosure Policies and Procedures
 - Disclosure Training
 - Highly Qualified Professionals Compose SFMTA's Disclosure Team---SFMTA staff, City Attorney, Financial Advisors, Disclosure Counsel and Bond Counsel



The End

