

WHAT ARE THE RESPONSIBILITIES OF THE BOARD OF DIRECTORS FOR SAMTRANS BOND DISCLOSURES?

FEBRUARY 2025

DISCLOSURE TRAINING



WHY DID CONGRESS ADOPT FEDERAL SECURITIES LAWS?

- *It is helpful to know why Congress adopted the federal securities laws and created the United States Securities and Exchange Commission:*
 - Securities presented quite the conundrum to Congress in the early 1930's:
 - They were not like goods or services because they were just investments and thus the quality of the security couldn't be objectively evaluated from a legal perspective; BUT
 - The one thing an investor needs is accurate, complete and timely information about the security to make a good investment decision.
 - Congress adopted the federal securities laws to recognize that the purchase and sale of a security is a different economic transaction than others and thus required laws to ensure that investors receive the information they need to make good investment decisions.
 - In many regards, the **Securities Exchange Commission's** entire mission is to ensure that these laws are enforced but also that investors of securities receive the kind of information they need to make informed investment decisions.



WHO IS THE SEC AND WHY IS IT SO CONCERNED ABOUT OUR MARKET?

- **The Securities Exchange Commission, which was created by the securities laws, enforces the Federal antifraud laws, which require issuers to be reasonable in providing investors a complete and accurate description of what issuers are offering investors to buy.**
- **The SEC has substantially increased its efforts to enforce these laws in the municipal securities market because it believes that the market suffers from a number of problems.**
- **These problems include:**
 - **“Silo” Effect:** SEC is concerned when 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 systematic process:** SEC believes that too many issuers in the market do not have a careful process to ensure that their disclosure documents are accurate and complete, or fail to train relevant employees.
 - **Inappropriate impact of 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.

WHAT ARE ISSUERS OBLIGATIONS UNDER THE FEDERAL SECURITIES LAWS?

➤ ***The only Federal securities laws to which municipal entities are subject are the Federal antifraud laws.***

❑ Unlike corporate issuers, the SEC cannot tell municipalities what to put in its disclosure or require them to obtain the SEC's approval.

➤ ***The Federal antifraud laws require that:***

❑ Municipalities use reasonable care to ensure.....

❑ That all of the information municipalities prepare in connection with its bond offerings.....

✓ Is “materially” accurate....and

✓ Does not omit a “material” fact that makes that information misleading.



WHAT ARE ISSUER'S OBLIGATIONS UNDER THE FEDERAL SECURITIES LAWS?

The Two Applicable Federal Securities Law Provisions

— **Rule 10b-5**

- The responsibility must be “scienter” which requires a finding of knowledge or recklessness.
- Individual bondholders may bring a Rule 10b-5 claim if they have suffered damages

— **Section 17(a)(2)**

- The responsibility can be merely negligence.
- Only the SEC can bring an action for a Section 17(a)(2) violation
- Must be a finding that the statement was made to obtain money or property.

WHAT ARE ISSUER'S OBLIGATIONS UNDER THE FEDERAL SECURITIES LAWS?

How does securities fraud differ from other kinds of fraud?

— ***Not just misstatements but also omissions***

- Evaluates the totality of the statements and considers not just whether it is accurate but also if it is misleading.

— ***Does not need to be intentional – even negligence can violate the Federal antifraud laws.***

- The SEC can bring an action under the Federal antifraud laws if the issuer acts with negligence and the disclosure contains a material inaccuracy or material omission of fact that is misleading.

WHAT ARE ISSUER'S OBLIGATIONS UNDER THE FEDERAL SECURITIES LAWS?

What is material?

- Any fact a reasonable investor would consider to be important in making an investment decision.
- Objective standard.
- Does not matter if the information is confidential.
- Forward-looking trends can be material—not just historical information.
- Can look very different in retrospect than at the time!

WHAT THE SEC IS DOING AND WHY IT IS SO CONCERNED

— *Extraordinary Enforcement Activity*

- City of San Diego
- State of New Jersey
- State of Illinois
- State of Kansas
- City of Harrisburg
- City of Allen Park
- Wenatchee
- Port Authority
- City of Miami
- Among others....

OK: SO WHAT DO ISSUERS NEED TO DO?

- Tell the credit story when issuing new bonds and make sure that any “elephant in the room” is disclosed in initial disclosure documents
- Adopt good disclosure policies and procedures
- Staying on top of secondary market disclosure: Disclosure after – sometimes years after – the bond issuance as required under Rule 15c2-12, which requires underwriters to execute a contract with issuers and borrowers of municipal securities to provide updates to investors concerning their financial and operating condition

WHAT ARE ISSUERS REQUIRED TO DO TO COMPLY WITH THE FEDERAL SECURITIES LAWS WHEN ISSUING BONDS?

- **Tell the credit story**

- **Why?** Almost all SEC actions against municipal issuers are the result of the municipal issuer failing to communicate to investors a major trend, development or risk that investors should know when making an investment decision.
- **What is the credit story?** It means telling the “big picture” of what matters to investors, from the investor’s perspective. When an issuer prepares an offering document or an annual report, the issuer needs to be sure that it **both** provides investors all of the information they need to make a good investment decision **and** provides that information in a way that investors can understand.
 - It means making sure all appropriate employees are involved to ensure the whole story is told;
 - It means telling the bad news along with the good news; and
 - It means thinking about the information in disclosure documents from an investor’s perspective and not from the perspective of someone inside the issuer.
- **“Elephants in the room.”** Often times, telling the credit story comes down to making sure that the major developments or problems facing an issuer or the repayment source of the Bonds are effectively communicated to investors.



WHAT ARE ISSUERS REQUIRED TO DO TO COMPLY WITH THE FEDERAL SECURITIES LAWS WHEN ISSUING BONDS?

- **Develop sound policies and procedures**
 - **Connect silos:**
 - Municipalities naturally have several departments that operate independently from each other and this can present challenges to preparing effective disclosure.
 - Policies and procedures should ensure that these “silos” are properly connected.
 - **Develop a working group:** Policies and procedures should include a working group that will be responsible for the issuer’s disclosure process and meaningfully review and discuss its disclosure.
 - **Documentation:** Policies and procedures should require that the issuer document its compliance.
 - **Training:** Policies and procedures should ensure that the individuals involved in the disclosure process understand the issuer’s responsibilities and their own responsibilities under the federal securities laws.

WHY DID THE SEC CREATE CONTINUING DISCLOSURE REQUIREMENTS PURSUANT TO RULE 15C2-12?

- The federal securities law requirements for corporate securities are much more extensive than for municipal securities—and knowing that is really important to understand why the SEC is so serious about continuing disclosure.
 - Public companies are required to file extensive registration statements that the SEC reviews and must approve before offering securities to the market and are also required to file annual, quarterly and material event filings.
 - The only federal securities laws that apply directly to issuers and borrowers of municipal securities are the federal antifraud laws—which, very generally, only requires them use reasonable efforts to ensure their disclosures are accurate and complete.
- Before the SEC amended Rule 15c2-12 in 1994, issuers and borrowers of municipal securities had no obligation to provide updates to investors concerning their financial and operating condition.

WHY HAS THE SEC FOCUSED EVEN MORE ON CONTINUING DISCLOSURE IN THE LAST 10 YEARS?

- **MCDC....**
 - What happened?
 - Why was it so big?
 - It was the long-awaited nuclear bomb in our industry....
 - Demonstrated the SEC's persistence and seriousness...
 - Demonstrated the SEC's willingness to be creative....
 - What is the aftermath?
 - Well-staffed and well-funded unit at the SEC focused just on our market....
 - Commissioner focus on the market...
 - Close monitoring of our market.

WHY HAS THE SEC FOCUSED EVEN MORE ON CONTINUING DISCLOSURE IN THE LAST 10 YEARS?

- ***What is the result of all of these developments?***
 - Well-staffed, well-funded unit at the SEC...
 - An SEC that still believes that the municipal securities market isn't sufficiently updating investors on financial and operating data....
 - Investors continuing to complain about failures of continuing disclosure...
 - An SEC that remains frustrated that corporate-styled periodic reporting requirements do not apply to issuers in the municipal securities market...
 - SEC is determined to fix as many of these kinds of problems in our market.

WHAT DO OUR CONTINUING DISCLOSURE UNDERTAKINGS REQUIRE US TO DO?

- ***What most issuers and borrowers know:***
 - File annually:
 - Audited financial statements; and
 - Audited financial report that updates financial and operating data presented in the final official statement for the municipal securities; and
 - File within 10 business days' notice of the occurrence of 16 events (or for transactions completed before February 27, 2019, 14 events).
- ***This requires:***
 - Systems to meet calendar deadlines for annual filings;
 - Procedures to ensure everything is included in annual financial reports; and
 - Procedures to track potential listed events.

WHAT DO OUR CONTINUING DISCLOSURE UNDERTAKINGS REQUIRE US TO DO?

- ***What many issuers and borrowers do not know:***
 - ***All continuing disclosure filings also are “statements” tested under the federal antifraud laws!***
 - Issuers and borrowers should also take reasonable steps to ensure that the information contained in any continuing disclosure filing satisfies the federal antifraud laws....
 - Which means:
 - The issuer or borrower needs to take reasonable steps to ensure that the information in the filing...
 - Does not make a material misstatement...and
 - Does not omit a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

WHAT DO OUR CONTINUING DISCLOSURE UNDERTAKINGS REQUIRE US TO DO?

- ***This requires:***
 - Good process to make sure everything that the issuer or borrower states in a filing is accurate; and
 - Good process to ensure that the filing does not omit important information which entails:
 - Knowing the “circumstances” of the filing.
 - Good “internal due diligence” to make sure that all individuals who have key information are appropriately involved in the filing to ensure that the filing does not omit a material fact that would render the filing misleading.

WHAT DO GOOD CONTINUING DISCLOSURE PRACTICES LOOK LIKE?

- ***Written policies and procedures that address:***
 - Good calendaring;
 - Clear identification of a coordinator;
 - Clear identification and assignment of responsibilities to the right people;
 - Clear procedures to ensure the right people meet together at the right times and ask the right questions;
 - Good compliance check to ensure the filing includes all required information; and
 - Good listed event procedures.

WHAT DOES SAMTRANS STAFF DO TO COMPLY WITH THESE REQUIREMENTS?

- **Based on SEC guidance, here are the main actions that SamTrans staff is focused on:**
 - *Maintaining and complying with Disclosure Policies and Procedures*
 - The Board is adopting disclosure policies and procedures at this Board Meeting
 - SamTran's policies and procedures:
 - Identify all relevant subject matter experts and ensure they are appropriately involved;
 - Maintain a Disclosure Working Group, which is responsible for the disclosure process as well as reviewing and meeting together to discuss SamTrans's ongoing disclosure obligations under Rule 15c2-12;
 - Have a Disclosure Officer, who is responsible to ensure and document that SamTrans complies with the policies and procedures.

WHAT ARE THE DIRECTORS RESPONSIBLE TO DO?

❑ ***Make a reasonable delegation in connection with future bond issues***

- It is important for the Board to be aware of the steps that SamTrans staff will be taking in connection with any future public bond issuances to ensure accurate and complete disclosure.

❑ ***You yourselves are part of SamTrans's disclosure policies and procedures:***

- SamTrans needs to make sure that your unique knowledge and perspective of significant facts and developments of SamTrans are included into SamTrans's disclosure.
- Directors should do an “elephant in the room” analysis to ensure that they are not aware of major trends or developments that may not be appropriately disclosed.
- Directors should feel free to discuss with SamTrans staff key developments at SamTrans – especially the ones SamTrans staff may be unaware of – so that SamTrans staff can fold that information and perspective into both its disclosure at the time of future offerings but also to ongoing investor disclosures outside of any future offerings that are becoming increasingly important.

APPENDIX A: 15C2-12 EVENTS

- (i) principal and interest payment delinquencies;
- (ii) non-payment related defaults, if material;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;
- (vi) 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;
- (vii) modifications to rights of security holders, if material;
- (viii) bond calls, if material, and tender offers;
- (ix) defeasances;
- (x) release, substitution, or sale of property securing repayment of the security, if material;
- (xi) rating changes;
- (xii) bankruptcy, insolvency, receivership, or similar event of the Issuer or another obligated person;
- (xiii) the consummation of a merger, consolidation, or acquisition involving the Issuer or another obligated person or the sale of all or substantially all of its assets, 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;
- (xiv) appointment of a successor or additional trustee or the change of name of a trustee, if material;
- (xv) incurrence of a Financial Obligation of SamTrans, if material, or agreement to covenants, events of default, remedies, priority rights or other similar terms of a Financial Obligation of SamTrans, any of which affect security holders, if material; and
- (xvi) default, event of acceleration, termination event, modification of terms or other similar events under a Financial Obligation of SamTrans, if any such event reflects financial difficulties.

