

Kansas Board of Regents Institutions
Public Markets Disclosure Training
(Pledge of General or Specific Revenues by a University)

KDFA
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KUTAK
ROCK

Presenters

Joel W. VanderVeen
D (402) 231-8809 | O (402) 346-6000 x1905
joel.vanderveen@kutakrock.com

Kathryn P. Peters
D (816) 502-4608 | O (816) 950-0090
kathryn.peters@kutakrock.com

Dawn M. Roth
D (402) 231-8772 | O (402) 346-6000
dawn.roth@kutakrock.com

This presentation is a general overview for training purposes and not intended as legal advice for any specific circumstance.

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Introduction

1. Bond issuance process and purposes for disclosure
2. Federal securities law and types of disclosure to which it applies
3. Evolution of regulatory environment and disclosure practices in the industry
4. Reasons for, and overview of University Disclosure Policies

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Bonds

- The University and its employees become subject to federal securities laws when the University chooses to finance its projects and expenditures through the use of revenue bonds, notes and other obligations ("Bonds") that are sold in the public securities markets.
- The Bonds are issued by K DFA as a "conduit" issuer for the University. While K DFA formally issues Bonds, the proceeds from the sale of the Bonds are deposited in the State Treasury, and the University agrees to make debt service payments to bondholders from pledged revenues.



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Key Steps of Issuing Bonds

- University requests issuance of Bonds by K DFA
- K DFA organizes finance team
- Documents circulated by counsel in draft form
- Following comment and revisions, documents finalized
- Rating agency review; ratings on bonds issued
- K DFA board approves the issuance of Bonds and substantially final documents
- University approves use of Preliminary Official Statement (POS), including University appendices
- POS is printed (all parties sign off) and is distributed to potential investors



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Key Steps of Issuing Bonds

(following the distribution of the POS)

- Bonds priced (negotiated sale or competitive sale)
- University approves final Official Statement (OS), including the University appendices
- OS printed (dated as of pricing date)
- Closing and delivery of Bonds (signatures and certificates delivered the day before at pre-closing); bond proceeds received by University



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Federal Securities Law

- Bonds are "securities" under federal securities law
- Although exempt from most of the provisions that apply to public companies, Bonds issued by or for the University are subject to the antifraud provisions of the securities laws
- The antifraud provisions apply to any statement made in connection with the offer, sale, or purchase of the University's Bonds
- Such statements are typically made:
 - In the POS and OS or in investor presentations
 - To rating agencies
 - In continuing disclosure filings
 - By University officials (intentionally or unintentionally) in speeches, publications, press releases and website postings reasonably expected to reach investors
 - These statements are referred to as public "**disclosure**"



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Purpose of Public Financial Disclosures

1. To inform investors and potential investors of the operations, financial condition and creditworthiness of the University, and
2. To provide sufficient information for investors to make informed investment decisions regarding the purchase or sale of the University's Bonds.



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Legal Standards for Disclosure

- **Rule 10b-5** under Section 10 of the Securities Exchange Act of 1934:

"It shall be unlawful for any person, in the offer or sale of any securities, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange.... 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..."
- Section 17(a) of the Securities Act of 1933 is similar.



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Statement or Omission

“... 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 federal antifraud rules with respect to disclosure cover both statements and omissions:
 - an untrue STATEMENT of a material fact
 - an OMISSION of a material fact necessary in order to make the statements made...
- As a result, a person preparing disclosure must consider both the statements made (or information provided), and statements not made (or information not provided).

Material Fact

- **A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision.** *Basic v. Levinson*, 485 U.S. 224, 231 (1988).

Material Omission

- **“An omitted fact is material if there is a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable [investor]. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”** SEC Release Nos. 33-7049; 34-33741 (March 9, 1994), p. 10-11 (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

Other Antifraud Rules

The federal securities laws also make it unlawful, in connection with the purchase or sale of any security:

- to employ any device, scheme, or artifice to defraud, or
- to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.



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Three Types of Disclosure

1. **Primary Disclosure** – Information provided to the markets in connection with the initial issuance and sale of Bonds by the University.
2. **Continuing Disclosure** – Certain information that the University has agreed to disclose on an ongoing basis under Continuing Disclosure Undertakings.
3. **Statements Reasonably Expected to Reach Markets** – Information that can be reasonably expected to reach investors and market participants.



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Primary Disclosure

- An **Official Statement** (and the Preliminary Official Statement) prepared by the University and distributed to the market in connection with the initial issuance of Bonds.
- The Official Statement is intended to be a comprehensive document describing all material aspects of the University's operations, financial condition and other information and of the Bonds being offered.
- The Official Statement under the current configuration includes:
 - > The "front part", including a description of the project being financed, the bonds, security for the bonds, investment considerations (bondholder risks), continuing disclosure compliance, other.
 - > The University (Appendix A) – a detailed description;
 - > Annual Financial Report of the University (Appendix B).



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Continuing Disclosure

The University is contractually obligated pursuant to its Continuing Disclosure Undertakings to electronically publish the following (referred to herein as an “Annual Report”):

- > Financial reports (the Annual Financial Report), audited if available;
- > Annual financial information and operating data (to update information originally in OS);
- > Notice of fourteen listed “Events” if they occur in connection with the University or its Bonds.
 - Principal and interest payment delinquencies;
 - Non-payment related defaults, if material;
 - Unscheduled draws on debt service reserves reflecting financial difficulties;
 - Unscheduled draws on credit enhancement reflecting financial difficulties;
 - Substitution of credit or liquidity providers, or their failure to perform;
 - Adverse tax opinions the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form gross-TRD) 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;
 - Modifications to rights of security holders, if material;
 - Bond calls, if material, and tender offers;
 - Defeasances;
 - Release, substitution, or sale of property securing repayment of the securities, if material;
 - Rating changes;
 - Bankruptcy, insolvency, receivership or similar event of the obligated person;
 - 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 action, other than pursuant to its terms, if material; and
 - Appointment of a successor or additional trustee or the change of name of a trustee, if material.

Statements Reasonably Expected to Reach the Markets

- These are voluntary statements reasonably expected to reach investors and the markets and may be material.
- Are all subject to the Rule 10b-5 standard to the extent such statements relate to information material to an investment decision. Such statements may include:
 - > Public statements, speeches, interviews, reports released, press releases and publications;
 - > Website postings;
 - > Statements and materials provided to rating agencies;
 - > Roadshows and group or individual investor calls; and
 - > Information to underwriters and financial or municipal advisors.
- These statements may be made anytime, not just during a bond offering.

Key Role of Rating Agencies

- Key information is provided to the Rating Agencies (Moody's, S&P and Fitch) to allow them to assign a credit (risk) rating, which investors consider in making investment decisions about the University's Bonds.
- Rating Agencies review information for initial ratings at issuance of bonds and for ongoing (often annual) surveillance to maintain ratings.
- Still, many investors (particularly institutional investors) don't rely on credit ratings and perform their own analysis, so primary and continuing disclosure remains important.

Duty to Speak

- Disclosure to the municipal securities market is required only when there is a duty to speak, which arises 1) at the time bonds are initially sold (POS and OS) and 2) as required by a continuing disclosure undertaking (annually and upon the occurrence of the listed events).
- At other times, issuers may chose to speak through voluntary continuing disclosure filings (regarding private placements, bank loans or other developments) or other statements reasonably expected to reach the market.
- Whenever statements are made to the market, whether because of a duty to speak or voluntarily, they are subject to the antifraud provisions of the Federal securities laws.

SEC Enforcement

- The Securities and Exchange Commission (the "SEC") may bring civil or administrative actions against issuers or individuals seeking monetary fines and other penalties, such as injunctions, cease and desist orders and requirements for remedial actions.
- SEC enforcement actions may be based on negligence only, or may cover more serious conduct involving scienter/known/reckless or intentional misconduct.
- The SEC does not have to show any loss to investors or reliance by investors on inadequate disclosure in order to extract monetary penalties or other remedies.
- The SEC may refer a criminal complaint to the Justice Department.
- Investors/bondholders may bring actions under Rule 10b-5, if they have suffered harm and relied on disclosure.

SEC Enforcement Actions

- 2010 – The first state settled with the SEC in a municipal disclosure enforcement action; involved pension disclosures; SEC described importance of written disclosure policies (State of New Jersey).
- 2010 – Civil monetary penalties were imposed upon municipal employees and officials for the first time; followed the City's 2006 settlement with the SEC regarding pension disclosures; penalties paid by individuals ranged from \$5,000 to \$25,000 (City of San Diego, California).
- 2013 – Misleading statements regarding continuing disclosure compliance were for the first time the subject of enforcement against a municipal issuer (West Clark Community Schools (Indiana)).

SEC Enforcement Actions

- 2013 – The first monetary penalty (\$20,000) was paid by a municipal issuer in a settlement with SEC involving misstatements regarding the existence of unfavorable feasibility studies (Wenatchee Regional Events Center Public Facilities District (Washington)).
- 2013 – Statements in an annual “state of the City” address were the subject of the first SEC charges against a municipality for misleading statements made outside of its securities disclosure documents (City of Harrisburg, Pennsylvania).
- 2014 – SEC invoked control person liability against a municipal official not directly involved in the bond financing and imposed its first bar on municipal officials from participation in future offerings (City of Allen Park, Michigan).

SEC Enforcement Actions

- 2014 – An injunction to halt a municipal bond offering was obtained by the SEC (City of Harvey, Illinois).
- 2014 – The State of Kansas settled with the SEC regarding pension disclosures, becoming the third state to do so.
- 2015 – SEC charged 72 underwriters under the SEC’s 2014 Municipalities Continuing Disclosure Cooperation (MCDC) Initiative. Each of the firms settled the actions and paid civil penalties up to a maximum of \$500,000.
- 2016 – First federal jury trial by the SEC against a municipality or one of its officers for violations of federal securities laws (City of Miami; Michael Boudreaux).
- 2016 – the SEC charged from 71 issuers and obligors in 45 states under the MCDC Initiative for inaccurate descriptions of compliance with prior continuing disclosure undertakings

SEC Enforcement Actions

- 2016 – Westlands Water District becomes the second municipal issuer to pay a financial penalty (\$125,000) in an enforcement action; District manager and assistant manager paid individual penalties of \$50,000 and \$20,000.
- 2017 – SEC charges issuer and underwriter that did not participate in MCDC Initiative with disclosure failures (Beaumont Financing Authority, Beaumont, California).
- 2017 – Port Authority of New York and New Jersey became the first municipal issuer to admit wrongdoing in an SEC enforcement action.
- 2017 – SEC charged Oyster Bay, New York with disclosure fraud in federal court and again used control person liability against a former elected official in connection with indirect guarantees of private loans to a vendor that were not properly disclosed.

Recent SEC Enforcement Actions

- **Issuer MCDC Settlements (August 2016)**
 - As part of the SEC's voluntary self-reporting Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, the SEC accepted offers of settlement from 71 issuers and obligors in 45 states for selling securities using official statements that were not accurate regarding compliance with prior continuing disclosure undertakings.
 - The settlements were for negligence-based disclosure fraud under Section 17 of the Securities Act of 1933, without admitting or denying the charges, and accepted an order to cease and desist from future violations. No monetary penalties were assessed.
 - Under MCDC, the issuers agreed to (i) adopt policies, procedures, and training regarding continuing disclosure obligations; (ii) comply with existing continuing disclosure undertakings; (iii) disclose the settlement in future offering documents; (iv) certify compliance with the settlement undertakings; and (v) cooperate with any subsequent investigations by the SEC.
 - In 2015 and 2016, SEC announced settlements against 72 underwriters (covering 96% of the market) as part of the MCDC Initiative.
 - The SEC continues to investigate those that did not self-report under the MCDC Initiative.

Recent SEC Enforcement Actions

- **Beaumont Financing Authority; O'Connor & Company Securities, Inc. (2017)**
 - A municipal financing authority in California and its executive director settled charges that they made false statements about prior compliance with continuing disclosure obligations. The underwriting firm and investment banker settled charges for failing to conduct reasonable due diligence on the continuing disclosure representations. They did not participate in MCDC.
 - BFA issued \$260 million in bonds in 24 offerings from 2003 to 2013. From 2004 to 2013, the obligated person regularly failed to comply with its CDAs. Reports were late by as many as 117 days and omitted required information. In 5 offerings in 2012 and 2013 the official statement included a statement indicating an annual report was filed late in 2002 but the obligated person otherwise had not failed to comply with its obligations.
 - BFA agreed to institute policies and procedures and hire an independent consultant.
 - The executive director paid a penalty of \$37,500 and agreed to be barred from participating in any future municipal bond offerings.
 - Underwriter paid a civil penalty of \$150,000 and agreed to retain an independent compliance consultant.
 - The investment banker paid a civil penalty of \$15,000 and agreed to a six-month suspension.

Recent SEC Enforcement Actions

- **Port Authority of New York and New Jersey (2017)**
 - The Port Authority approved \$1.8 billion in projects, and initially allocated bond proceeds towards funding certain projects, without disclosing known material risks surrounding the potential lack of legal authority to fund those projects.
 - Official Statements contained statements concerning the Port Authority's legal authority with respect to bonds, including that the Port Authority issued bonds "only for purposes for which the Port Authority is authorized by law to issue bonds."
 - The Port Authority acknowledged that its conduct violated Sections 17(a)(2) and (3) of the Securities Act in connection with the offer and sale of over \$2.3 billion of its bonds between January 2012 and June 2014.
 - Port Authority voluntarily enhanced procedures for approval of capital projects, retained outside bond counsel for all bond offerings and hired a new permanent general counsel.
 - Port Authority agreed to establish written policies and procedures, hire an independent consultant and pay a \$400,000 penalty.

Recent SEC Enforcement Actions

□ SEC v. City of Miami and Michael Boudreaux (2016)

- In September 2016, after a trial in federal court, a jury found that the City of Miami and its former budget director, Boudreaux, made materially false and misleading statements and omissions about certain inter-fund transfers in the City's CAFR and in three 2009 bond offerings.
- Following the jury verdict, the City entered into a settlement with the SEC stating that its actions violated a 2003 SEC cease-and-desist order against the City that was tied to an earlier securities fraud case involving the City's failure to disclose its deteriorating financial condition in three 1995 bond offerings. The City is the only issuer found to have violated an existing cease-and-desist order.
- The City settled with the SEC and paid a \$1 million penalty, the largest the SEC has ever imposed on a municipality.
- The SEC won a jury trial against Boudreaux and sought to impose a \$450,000 civil monetary penalty against him, the court reduced the penalty to a \$15,000.

State of Kansas Consent Order

- In August 2014 the State of Kansas agreed to a consent order with the SEC to settle SEC allegations regarding pension fund disclosure for bonds issued in 2009 and 2010 that were payable from appropriation of the state general fund. The SEC order stated that disclosure in connection with those bonds failed to adequately disclose the existence of the unfunded liability in KPERS and the effect of such an unfunded liability on the risk of non-appropriation of debt service payments by the Kansas state legislature.
- Without admitting or denying the order's findings, the State agreed to cease and desist from causing any future violations of antifraud provisions of the federal securities laws.
- The SEC attributed the disclosure deficiencies in part to a prior lack of formal written disclosure policies or procedures, and acknowledged favorably the adoption of new disclosure policies and procedures in 2011 that contained elements of the disclosure procedures cited in New Jersey in 2010.

Lessons Learned

1. Disclosure should contain all information material to an investor making an investment decision.
 - a) Other publicly available information may be part of the "total mix of information," but to the SEC, the fact that information is publicly available may not, by itself, be sufficient to satisfy disclosure requirements.
 - b) Disclosures cannot omit information material to such disclosures, even if disclosure of the information will be harmful.
 - c) It is generally preferable to say too much rather than too little.
2. Do not bury important details. Presentation is important, and significant issues, concerns, policies and developments should be highlighted.

Lessons Learned

- Information must be up to date. If the picture presented in historical financial information, reports or disclosure documents has materially changed, then say so.
- SEC focus is broad, not confined to one topic, and includes proceedings based on disclosure relating to: pension funding and obligations, investment product risks, cash flow problems, structural deficits, project cost overruns, bad financial statements, stale financial statements, inflated property values, collapsed PPP projects, tax covenant non-compliance, and continuing disclosure compliance.
- The SEC staff considers written policies and procedures to be important for large or complex organizations to comply with disclosure obligations.

Lessons Learned

- The SEC has made it clear that it considers individuals to be responsible for disclosure of a municipal entity and it will hold municipal officers, officials, key employees and “control persons” responsible for inadequate disclosure. Officials and officers and others involved in or responsible for the preparation of disclosure information should review each offering document and confirm that it comports with their understanding of the financial and operational condition of the issuer or obligor.
- Strict compliance with continuing disclosure undertakings is important to the SEC and its enforcement staff.
- Lack of resources is not a defense. Issuers/obligors that access the public securities markets are expected to staff appropriately in order to meet their obligations under the securities laws.

University Disclosure Policies

□ Purposes

- Ensure University compliance with federal securities laws.
- Establish a standardized process for collection, review and updating of information include in the University’s disclosure.
- Identify the roles of each office and individual with responsibility for collecting, reviewing and verifying disclosure information.
- Provide basis for reliance in signing closing certifications (that there are no material misstatements or omissions) and help to rebut any allegation of negligence.
- Comply with SEC staff admonitions and pronouncements such as the stated remedies for the SEC’s Municipalities Continuing Disclosure Cooperation (MCDC) Initiative.

University Disclosure Policies

- It is important to tailor policies and procedures to the circumstances of each University, so there are differences in policies, but elements to satisfy the purposes of the policies should be maintained.
- Policies identify key participants, including one primary person (a "Primary") in each relevant office or department to collect, review and coordinate information for the Official Statements and University Filings.
 1. Finance/financial reporting/budgeting
 2. General Counsel
 3. Admissions/enrollment
 4. Research
 5. Provost
 6. Student Life
 7. Others



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Disclosure Team

- **Composition**
 - The University President or Chancellor is responsible for appointing the Disclosure Committee or Team (the "Disclosure Team"), which has general oversight of the entire disclosure process.
 1. Vice President of Finance or Chief Financial Officer (serves as Chair)
 2. Representative(s) from:
 - A. Finance/financial reporting
 - B. Budget
 - C. General Counsel
 3. Others



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Official Statement Preparation

- **Procedures**
 1. Send notice to each Primary or member of the Disclosure Team to ask them to review draft disclosure and raise potentially significant matters.
 2. Each Primary or member of Disclosure Team will document in writing all information provided by them, will review and sign off on information provided by them and will certify that the University Disclosure Policy was followed.



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Official Statement Preparation

□ Procedures

3. Each Primary is responsible for consulting with staff concerning:
 - a. Pending or approved legislation;
 - b. Known and threatened litigation;
 - c. Proposed and actual actions of the government; and
 - d. Strategic and policy considerations.
4. Matters deemed significant should be reported to the University Disclosure Team.
5. Compile a draft of the Official Statement or Annual Report for review and comment by the Primaries.

Official Statement Preparation

□ Procedures

6. Review the comments received to complete the draft Official Statement or Annual Report.
7. The University Disclosure Team reviews all data and all significant items and serves as the final level of review of the Official Statement or University Filing before review by the President/Chancellor of the University.
8. Upon approval by the President/Chancellor the Official Statement or Annual Report may be used.

Official Statement Preparation

□ Timing of Certifications

- Formal representations and certifications regarding the information in the Official Statement are made at the time of:
 1. Printing of a Preliminary Official Statement;
 2. At the pricing and sale of the Bonds; and
 3. Upon the closing and delivery of the Bonds.
- As a result, it is important to check for any potential material developments at these times.

Official Statement Preparation

□ Material Changes

- To ensure that there have been no material changes in the financial condition and affairs of the University, upon the printing of a Preliminary Official Statement, the signing of a purchase contract or taking of bids, and the pre-closing/closing:
 1. Contact the Primaries or their designees to ask if there have been any significant or potentially material developments.
 2. General Counsel will conduct an internal review regarding litigation.
 3. If a potentially significant development is identified, it will be raised to Disclosure Team for review.

University Annual Financial Report

□ Financial Information Is a Critical Component of Disclosure

The Annual Financial Report of the University ("AFR") is part of the Official Statement and part of Continuing Disclosure.

Prior to the finalization and release of the AFR, the Primaries or Disclosure Team should review a draft of the Management's Discussion and Analysis to be included in the AFR.

The AFR, including the Management Discussion and Analysis, is subject to the antifraud rules of federal securities law and, as a result, is subject to similar procedures as is the primary disclosure in Official Statements.

Annual Continuing Disclosure

To the extent required by Continuing Disclosure Undertakings (CDA's) for each issuance of bonds, certain operating data and financial information will be updated, revised and filed annually at the time required by the CDA's.

- University AFR.
- Financial information and operating data presented in tabular form in the original Official Statement.
- Though only the information in tables is generally required, context may be provided, if necessary.
- Timing—normally expected to coincide with the release of the AFR near the end of the calendar year for the prior fiscal year ended June 30.

Annual continuing disclosure filings are subject to similar procedures as is the primary disclosure in Official Statements.

Good Practices

- Matters that members of a particular office or department believe to be significant should be reported to, and reviewed by, the Disclosure Team.
- Proper updating of disclosure information should be more than a mechanical process of completing a template; it requires thoughtful consideration of all the circumstances.
- Be mindful of material changes in circumstances that may affect prior statements to the market, so that consideration can be given to any necessary updates to disclosure.



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Summary

- Proper disclosure to the securities markets is important to the financial operations and affairs of the University.
- Inadequate disclosure subjects the University and individuals to potential liability.
- Proper disclosure is an accurate, comprehensive statement of the University's finances, affairs and strategic posture.



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