

# UConn Disclosure Training

**Presented by:**

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## ■ Introduction of speakers and topics

- Marie Phelan
  - Primary responsibility for bond counsel and disclosure counsel representation of UConn
  - Sources of UConn obligation to provide disclosure
- Mike Andreana
  - Primary responsibility for state and federal tax compliance in connection with UConn's bond financing
  - Disclosure Standards and Enforcement of Securities Law
- Jessica Kennedy
  - Assist in UConn 2000 matters
  - Primary and Secondary Market Disclosure

- Securities and Exchange Act of 1934
  - Governs regulation of securities market administered by SEC
  - Jurisdiction over underwriters and other market participants, not issuers directly
    - Underwriter may not sell bonds unless it has read and distributed an Official Statement and until issuer enters into a Continuing Disclosure Agreement
  - Contains antifraud provisions which do apply to issuers, like UConn
    - Applicable not only to information formally disclosed to market but also to information included in press releases, oral presentations by senior management or anything that might be reviewed by investors as information considered in its purchase or sale of bonds

# Source of Disclosure Obligations

- Master Indenture
  - Contract between issuer and bond holder
  - Provides for continuing disclosure obligation
    - Annual disclosure filed 180 days after end of fiscal year
    - Annual Information includes audited or unaudited financial statements (to be followed by audited financial statements once available) and updates to certain operating data which previously has been disclosed in an official statement
    - Disclosure of certain events
  - Serves as the continuing disclosure agreement for bonds issued prior to 2018

- Continuing Disclosure Agreement
  - For bonds issued after 2018
  - Changed timing of filing annual disclosure from 6 months after end of fiscal year to 8 months after end of fiscal year
  - Added new event disclosure, including the disclosure of certain financial obligations and changes to existing financial obligations

- Policy and Procedures
  - Adopted by University in 2018 in compliance with SEC encouragement
  - SEC and securities market look at positively if followed by issuer
  - If not followed – negative effect

- Today, we will discuss the following topics related to the Official Statement:
  - Purposes of the Official Statement;
  - Material Information;
  - Preparation of the Official Statement;
  - Disclosure (the old and the new expectations).

- Document prepared by UConn and is used in a public offering in the primary market to sell securities to investors;
- Provides a description of the transaction;
- Contains UConn's statements about its financial condition, certain operating data, the UConn 2000 Program and the sources of repayment;
- Discloses material information associated with investment in the securities, which may include the risks;
- Contains a summary of UConn's Continuing Disclosure obligations and whether it is in compliance, and if it has not been in compliance in any way during the last 5 years, it will be disclosed in the OS.

Contains material information on subjects like:

- Matters related to the UConn 2000 Program:
  - delays with projects and impact on delays;
  - increased costs related to projects;
  - environmental issues impacting the Program.
- Transactions that may impact UConn’s business and financial operations, such as:
  - mergers, acquisitions, disposition of assets or key personnel changes.
- Significant increases or decreases in revenues that are pledged for the bonds caused by housing, parking facility or other transportation developments;
- Changes in academic, admissions or student residence policies that might materially affect the University’s receipt of any component of revenues pledged to bonds.

Contains material information on subjects like:

- Management changes that could have a material impact on operations or finances;
- Structural or organizational changes, like opening a new school, doing away with an academic major or an athletic team, or expanding, consolidating or terminating any existing academic programs or adding additional programs;
- Other matters being considered by the Board of Trustees or the Board of Directors that, if adopted, would have a material impact on the operation or finances of the University or UConn Health;
- Areas of significant contention between the faculty and the administration;
- Any trends, changes or circumstances that have adversely affected or may adversely affect the University's or the UConn Health Center's future enrollment, including demographic and economic trends or financial aid prospects.

# UConn's Preparation of the Official Statement

- Executive Vice President for Finance and Chief Financial Officer (“CFO”) has primary responsibility; but must rely on many other people to fulfill the responsibility;
- CFO delegates supervision for preparation of the Official Statement to Peg and Chris who then work with a larger Working Group comprised of many of you to gather the content for the Official Statement;
- Members of the Working Group include officers and employees of UConn including officers and employees from the UConn Health Center who provide the content and should review the final draft of the Official Statement to make sure the information provided is accurately reflected;
- Working Group approves final OS; and certain members execute Certificate of Accuracy documenting their review of the OS;
- CFO relies on the Certificates of Accuracy of various departments in signing off on the Official Statement.

## Disclosure Concepts

- Historical information about the issuer is generally not helpful;
- Good faith attempts to provide appropriate current and forward-looking information will not be second guessed by the SEC;
- In making forward-looking statements, information should be accompanied by the assumptions that the issuer made in determining the information and the risks related to the information that would materially impact the forecasts not being as assumed;
- Material information should be disclosed as appropriate, including any impact events may have on operations and the financial condition of the issuer.

## **ESG Disclosure**

- ESG (Environmental, Social and Governance) factors are not just important for labeled bonds with an environmental purpose like “Green Bonds,” but are becoming increasingly more important in credit analysis and investing in the municipal securities market, generally.
- In 2021 and 2022, the major credit agencies continued integrating ESG considerations into their credit ratings analysis. Not every E, S, or G factor creates risk that will affect financial performance – varies based on the issuer and the project.
- As a result, issuers like UConn need to consider ESG disclosure in primary offerings.
- ESG related risks often involve remote and uncertain risks, and accordingly, a decision must be made by UConn about how material a remote risk is by weighing the potential consequences of the risk against the likelihood of its occurrence.

**E of the ESG = Environmental** - involves considerations of an organization's overall impact on the environment and the potential risks and opportunities it faces because of environmental issues. Examples include the following: Climate change; Energy consumption and efficiency; Carbon footprint, including greenhouse gas emissions; and Waste management, and Air and water pollution.

**S of the ESG = Social** - addresses how an organization treats different groups of people. Examples, include: Fair pay for employees, including a living wage; Diversity, equity and inclusion (DEI) programs; Employee/student experience and engagement; Treatment of students, professors and suppliers – any labor issues? strikes?; and Funding of projects or institutions that help poor and underserved communities;

**G of the ESG = Governance** - examines how UConn, and other organizations, police themselves, focusing on internal practices to maintain compliance with regulations, industry best practices and corporate policies. Examples include the following: Leadership and management; Board composition, including its diversity and structure; Regulatory compliance and risk management initiatives; and Ethical business practices.

## **ESG Disclosure**

Tools for developing an ESG related disclosure framework:

- Assess need for more detail with focus on UConn's ability to respond to risks.
- Disclosure should be specific to UConn; generic disclosure should be avoided.
- Management's approach to the risk – task force formed? Study undertaken?
- Mitigation plan in place? Mitigation steps and an evaluation of the steps taken to alter the strategy, if necessary.
- Financial impacts - Grants, insurance, new regulations in place leading to increased costs?
- Efforts to address ESG leading to relevant disclosure, such as, reductions in tax revenue or operating revenue as a result of consumer climate change adaptation.

## **ESG Disclosure – Climate Change**

- SEC considers climate related risks to be “material” because climate-related risks have present financial consequences that investors deem important.
- Some applicable climate related risks to consider for disclosure, include:
  - impacts of more frequent natural disasters;
  - impacts of changes in regulation of carbon and GHG emissions;
  - impacts of any climate related risk on changes in school enrollment or housing.

## ESG + Cybersecurity = ESGC?

- Cyber attacks present a huge risk to the value of enterprises and ultimately the stability of society.
- Newest recommendation is that Cybersecurity should be managed as part of your environmental, social and corporate governance strategy, rather than relying on insurance because insurance cannot mitigate the risk indefinitely.
- A standard framework for measuring cyber risk would help organizations manage it.
- Disclosure should include the issuer's attempts to prevent a cyber event, such as having a policy, employing mitigation steps, performing assessments of cybersecurity infrastructure, the results of the assessments and what the issuer will do in response to the results. Also, if an issuer has been hacked, the details of the hack should be disclosed, how the issuer remedied the problem, and steps it will take to avoid the event from occurring again.

- Secondary, or continuing disclosure, consists of important information about issuers of bonds that arises after the initial bond issuance;
- This information generally reflects the financial health or operating condition of the issuer as it changes over time, or the occurrence of specific events that can have an impact on key features of the bonds;
- Continuing disclosures are intended to assist investors in the secondary market in determining the suitability and risks of purchasing a bond.

# Secondary (Continuing) Market Disclosure (Cont.)

Under the Continuing Disclosure Agreements (the “CDA”) that are executed at the time bonds are issued, the issuer commits to provide to the marketplace certain **“annual financial information”** and **“operating data”** on an annual basis and notice of certain **“events”** set forth in Rule 15c2-12.

Updated financial or operating information about the university, such as:

- Annual financial information, including audited or unaudited financial statements (Annual Reports to include the operating data which may or may not be filed separately);
- A notice of failure to provide annual financial information on or before the date agreed to by the university must be filed;
- A late filing notice is an issue because it must be reported in Official Statements for five (5) years from the time the late filing occurred;
- Investors care about these disclosure mishaps and specifically review the Official Statement Continuing Disclosure sections where such late filing notices have to be explained.

Other continuing disclosures involve providing notification of specific events **within ten (10) business days of their occurrence**, such as:

- Principal and interest payment delinquencies;
- Non-payment related defaults;
- Bond calls;
- Bond defeasance; and
- Financial obligation.

- As a result of amendments to Rule 15c2-12 in 2019, issuers are now also required to report the incurrence of “financial obligations;”
- SEC guidance states that a financial obligation is intended to mean any material obligation that acts like a debt, meaning a borrowing of money to be repaid over time, regardless of its duration (short or long) or its name;
- Contracts that are not called debt instruments may be reportable and within the SEC definition of “financial obligation;”
- Any contract that requires the University to make periodic payments over time should be brought to the attention of Peg and Chris because it may be a “financial obligation” under the rule and need to be disclosed.

Below is a list of examples of “debt obligations” that you may not think to be disclosed but should be because they constitute financial obligations under Rule 15c2-12 are:

- 1) Installment purchase agreement;
- 2) Bonds or Notes privately placed;
- 3) Lease purchase agreements;
- 4) Lines of credit;
- 5) Payment of a judgment; and
- 6) Any promise to pay in the future for goods or services received today.

Periodic meetings that UConn holds on compliance are very important and recommended by NABL to make sure that events, like these financial obligations, that issuers are not used to reporting are in fact reported when they occur.

A financial obligation does NOT include:

- 1) Municipal securities for which a final official statement has been provided to the MSRB consistent with Rule 15c2-12;
- 2) Ordinary financial and operating liabilities.

- Voluntary disclosure is warranted when an event has the potential for challenging credit impacts;
- Examples of matters to voluntarily disclose may include the following and should be discussed with Peg and Chris so that a disclosure determination can be made:
  - COVID-19;
  - Discontinuation of a school department, a major or and athletic team;
  - Amended budgets;
  - Declines in occupancy/enrollment which could result in a decline in revenue receipts – emphasis on trends;
  - Declines in revenues pledged for debt service;
  - Cost-cutting measures, including employee lay-offs and labor issues;
  - Delays in construction projects;
  - Obtaining grants/loans – good news is as important as the “bad news.”

- Most governmental bonds (including UConn bonds) are considered securities under federal and state securities laws
- Governmental bonds are exempt from registration under the Securities Act and exempt from periodic reporting under the Exchange Act
- In addition, under the Tower Amendment, the Securities and Exchange Commission (“SEC”) and the Municipal Securities Rulemaking Board (“MSRB”) are prohibited from requiring any governmental issuer to submit information (including disclosure documents and periodic filings) to it before or after the sale of securities
- Why? Constitutional issues, absence of significant abuse, investor sophistication, costs of regulation
- However, antifraud provisions of the Securities Act and the Exchange Act are applicable to government bonds

- Two primary antifraud rules (apply to all securities including UConn bonds)
  - Section 17(a) is part of the Securities Act of 1933 (primary offerings)
  - Rule 10b-5 is promulgated pursuant to the Securities Exchange act of 1934 (secondary markets)
    - Provisions are designed to ensure that buyers and sellers of securities can make informed investment decisions
- Section 17(a)
  - “unlawful for any person in the offer or sale of any securities . . . by the use of any means of interstate commerce, or of the mails . . . to obtains money or property by means of any untrue statement of *material* fact or any omission to state a *material* fact necessary in order to make the statements made, in light of the circumstances, under which they were made, not misleading”
- Rule 10b-5
  - “unlawful for any person . . . by the use of any means of interstate commerce, or of the mails . . . to make any untrue statement of *material* fact or to omit to state a *material* fact necessary in order to make the statements made, in light of the circumstances, under which they were made, not misleading”

- “Materiality” is purposefully not defined by the SEC
- Concept of materiality has been developed, always in hindsight, through court decisions and SEC enforcement actions and guidance
  - Is the fact important in making an investment decision?
  - Does the fact significantly alter the “total mix” of available information?
  - A balancing of probability and magnitude
- Confidential, politically embarrassing or negative material are not defenses for omission
- **Issuer of governmental securities (UConn) has the ultimate responsibility and primary liability for material misstatements and omissions**

- Negligence standard is sufficient for Section 17(a)
- Rule 10b-5 requires scienter (intent, knowledge) or recklessness
- Enforcement Action Results
  - Civil fines against governmental issuers (up to \$1,000,000)
  - Engagement of consultants and lawyers to oversee disclosure practices
  - Civil fines against individuals (up to \$75,000)
  - Criminal convictions against individuals (2.5 years in jail)
  - Defense costs
  - After effects (reputational harm, ratings downgrades, lack of access to public markets)

- Over the last 10-15 years, the SEC has increased its focus on inadequate disclosure relating to governmental debt issues
- Dodd-Frank law gave the SEC the ability to level civil fines against governmental debt issuers in administrative proceedings
- SEC (unlike a private plaintiff) does not need to show loss of value or financial harm to investors
- In 2010, a Municipal Securities Unit was created within the Enforcement Division of the SEC
  - Renamed the “Public Finance Abuse Unit”
  - 20 enforcement actions in fiscal year 2022 (up from 12 in fiscal year 2021)
- Through its powers to directly regulate underwriters, financial advisors and rating agencies, SEC has been successful on imposing indirect disclosure obligations on governmental issuers (e.g. Rule 15c2-12)

- Orange County, California (1996)
  - County cash invested in risky investments that led to County bankruptcy
    - Inadequate financial disclosure of risky investments in Official Statements
    - County Board of Supervisors who had knowledge of investments had obligation to investigate and ensure adequate disclosure
- Failure to provide adequate pension disclosure
  - Includes actions against New Jersey, Illinois and Kansas and the City of San Diego
    - San Diego included fines against individual officers
    - Illinois was first action that focused on inadequate internal policies and controls for the disclosure process

- Issuer and Individual Fines and Penalties
  - Greater Wenatchee Regional Events Center Public Utilities District (2013)
    - SEC imposed fine against the issuer (\$20,000)
  - Miami, Florida (2016)
    - SEC imposed largest civil penalty against an issuer (\$1,000,000)
    - 2<sup>nd</sup> offense
- “Control Person” Liability
  - control person can be held liable for the securities law violations of individuals over whom he or she controls
    - Includes actions against City of Allen Park, MI, Town of Ramapo, NY, City of Harvey, FL, and Town of Oyster Bay, NY
- Criminal Liability
  - bad actors and bad actions
    - Includes actions against Town of Ramapo, NY and Town of Oyster Bay, NY

# History and Types of Enforcement Actions

- Thirty-three actions brought by the SEC in the last 2 years (including 7 against issuers and 1 against an auditor). SEC has brought recent enforcement actions against governmental issuers for a variety of disclosure issues, including:
  - Lack of internal financial controls
    - Sterlington, Louisiana (misuse of prior bond proceeds), Crosby Independent School District (Texas), Sweetwater Union High School District (California)
  - Misleading Financial Disclosure (false or outdated financial statements)
    - Includes actions against College of New Rochelle (two KPMG auditors), Johnson City, Texas, Rochester, New York, Sterlington, Louisiana (misuse of prior bond proceeds), Crosby Independent School District (Texas), Sweetwater Union High School District (California)
  - Failure to Disclose Risks
    - Includes actions against Port Authority of NY and NJ, Park View School, Tri-Valley Learning Corporation, Montebello Unified School District and Massachusetts Turnpike Authority (cost overruns)

- Aimed to address widespread noncompliance with Rule 15c2-12 by both issuers and underwriters
- SEC offered incentives (pre-determined fines and cease and desist orders) to issuers and underwriters for voluntary self-reporting of “material” incorrect statements in Official Statements relating to continuing disclosure compliance over the prior 5 years
  - Underwriters required to report first and underwriting industry decided to voluntarily report all instances without any consideration of “materiality”
  - Issuers followed and were forced in most cases to adopt the same standard

- Over 140 enforcement actions brought by the SEC against underwriters (72) and issuers (71 issuers, including two in CT) for false statements relating to issuer's 5-year compliance obligations under Rule 15c2-12. Most common violations included:
  - Late filings of annual information and notice events
  - Rating changes (upgrades and downgrades)
- SEC used negligence standard available under Section 17(a)
- Later enforcement actions against Rule 15c2-12 violators that did not self-report received harsher penalties

# Statements Outside of the Official Statement

- Securities law standards can be applied to instances where an issuer or its officials are “speaking to the market.”
- Examples include:
  - EMMA Filings (Johnson City, TX)
    - False financial statements
  - Investor “road shows” material
    - Limit information to material included in the official statement
  - Issuer Websites (Harrisburg, PA)
    - Inconsistent statements on website compared to audited financials



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