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Market Advisory

Market Advisory on Selective Disclosure

Introduction

The Municipal Securities Rulemaking Board (MSRB) is aware of the practice of certain municipal securities issuers making selective disclosure, which occurs when certain classes of investors are given access to information but other investors are not. The select investors privy to this nonpublic information typically include analysts for investment banking firms, investment advisers or institutional investors. The MSRB is publishing this market advisory to increase awareness of selective disclosure and to educate market participants, particularly MSRB registrants who share in the responsibility of protecting the integrity of the market, on its potential negative impact on them, investors and the market as a whole.

Selective disclosure may occur when the issuer presents pertinent information relating to an offering of securities and/or underlying credit to current or prospective investors, for example, during road shows, investor conferences and one-on-one investor calls or meetings. These events are not inherently problematic, but they can become so when the information conveyed is nonpublic and material. Selective disclosure is more likely to occur when the presentation of information is not consistent from one communication to the next. For example, investor conferences and investor calls often include question-and-answer sessions, which place the issuer at risk of discussing nonpublic material information, such as information that is not included in the preliminary official statement. Selective disclosure can also occur in the secondary market when the original disclosure documents were accurate and complete, but the issuer provides new nonpublic material information, which is not required to be disclosed pursuant to Rule 15c2-12 under the Securities Exchange Act of 1934 (“Exchange Act”) or any other rule, to select investors or analysts.¹ In these instances, selective

¹ Under Exchange Act Rule 15c2-12, an underwriter is prohibited from purchasing or selling municipal securities in connection with an offering unless the underwriter has “reasonably determined” that an issuer or an obligated person has undertaken in a writing to provide continuing disclosure information regarding the security and the issuer or obligated person, which includes notices of the occurrence of certain events. Such notices must be provided within 10 business days of the occurrence of the event.



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disclosure may impede market fairness, which may diminish investors' confidence in the integrity of the market.

Regulatory Framework

The issue of selective disclosure is not unique to the municipal securities market, as public companies, which issue equity and debt securities and are subject to registration and reporting requirements under the Securities Act of 1933 ("Securities Act") and the Exchange Act, have also engaged in the practice. To address this practice by these corporate issuers, in 2000, the Securities and Exchange Commission (SEC) adopted Regulation Fair Disclosure, more commonly known as Regulation FD.² The regulation provides that, when an issuer, or person acting on its behalf, discloses material nonpublic information to certain persons (*e.g.*, brokers, dealers, investment advisers and investment companies), it must publicly disclose that information.³ If the selective disclosure was intentional, the issuer must make the public disclosure simultaneously; if it was unintentional, the issuer must make the public disclosure promptly.⁴ The disclosure may be made either by a public filing with the SEC or "another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public."⁵

While Regulation FD has addressed selective disclosure by public company issuers, it does not apply to municipal issuers, as municipal issuers are exempt from regulation by the SEC with limited exceptions.⁶ Similarly, while the Exchange Act provides the MSRB with broad authority to write rules governing the activities of brokers, dealers, municipal securities dealers (collectively, "dealers") and municipal advisors,⁷ it does not provide the MSRB with authority to write rules governing the activities of issuers. Additionally, municipal securities are exempt from the registration and

² See Exchange Act Release No. 43154, 65 FR 51716, 51716 (Aug. 24, 2000).

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ In addition to the continuing disclosure requirements of Exchange Act Rule 15c2-12, municipal issuers are subject to the antifraud provisions of both the Securities Act and the Exchange Act.

⁷ See 15 U.S.C. 78o-4(b)(2).

prospectus delivery requirements of the Securities Act and are exempt from the registration and reporting requirements of the Exchange Act.

Although municipal issuers are not subject to Regulation FD or a similar obligation, they are not completely free from regulation, and selective disclosure can create liability for them, as well as for any dealers or municipal advisors that participate in or otherwise facilitate the practice. As noted above, municipal issuers are subject to the antifraud provisions of the Securities Act and the Exchange Act,⁸ which generally prohibit fraud (typically in the form of material misrepresentations or deceptive devices, schemes or conduct) in the offering, purchase or sale of securities. Accordingly, there are multiple ways in which selective disclosure could lead to potential violations of these provisions. For example, to the extent the selective disclosure is of nonpublic material information and that information was known to the issuer at the time of, but was not included in, a preliminary official statement, official statement or other required disclosure, the relevant documents likely would suffer from a material omission or misstatement. Further, should an individual make a selective disclosure in breach of a duty to the issuer, and the recipient of the nonpublic material information purchases or sells the issuer's securities on the basis of that information, it could constitute insider trading.

While selective disclosure is attributed to actions of the issuer, in practice, it may be done in concert with or facilitated by dealers, acting as underwriters, and/or municipal advisors. For example, dealers and municipal advisors often plan and participate in road shows and investor conferences. Given this direct connection to the selective disclosure, these intermediaries may also incur liability under the antifraud provisions for their part. This liability could include aiding and abetting, or causing, the issuer's violations, or their own direct violations. In addition, any selective disclosure that creates potential liability under the Securities Act and the Exchange Act could similarly trigger potential violations by dealers or municipal advisors of MSRB Rule G-17, which requires that dealers and municipal advisors deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice. The rule contains an antifraud prohibition similar to the standard set forth in the Exchange Act; however, it also establishes a general duty to deal fairly, even in the absence of fraud. In the case of road shows and investor conferences, a common practice is for a lawyer to review the oral script and any materials distributed, to be certain that no information is conveyed that is not within,

⁸ See Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5 and other related rules.

or reasonably inferred from, the information in disclosure documents available to the general market.⁹

The purpose of this market advisory is not to discourage direct communications between issuers and investors and/or analysts, as road shows, investor conferences and other similar communications are legitimate market practices that are not inherently problematic. However, if those communications include nonpublic material information, there is risk of regulatory consequences under the federal securities laws, including MSRB rules, to issuers, dealers and municipal advisors, of which the market should be reminded.

Current Practices in the Municipal Securities Market

The MSRB is providing three basic examples below to highlight how instances of selective disclosure may occur in the municipal market.

Example 1:

Issuer A is a state housing development authority that has issued one series of single-family mortgage revenue bonds. The official statement describes the relationship between the bond maturities and the scheduled mortgage loan repayments. It also describes provisions in the trust indenture that require a mandatory call at par from mortgage loan prepayments that exceed their expected rate. An employee of Issuer A, in a one-on-one conversation with an institutional investor, shares that the level of prepayment of mortgage loans related to the bonds is higher than expected based on initial prepayment models, which allows that investor to gauge the likelihood of its bonds being redeemed.

Example 2:

Issuer B is a city that has recently settled a lawsuit, but the details of the settlement have not been made public. The city is aware that the amount owed by the city will be substantially less than originally expected. In an effort to provide transparency to investors, Issuer B holds a conference call with all current bondholders to provide additional information related to the lawsuit. However, this information is not provided to potential future investors or the market more broadly.

⁹ See NetRoadshow, Inc., SEC No-Action Letter, 2013 WL 368363 (Jan. 29, 2013), *available at* <https://www.sec.gov/divisions/marketreg/mr-noaction/2013/netroadshow012913-15c2-12.pdf>.

Example 3:

A municipal advisor is hosting a general informational meeting for an invited group of buy-side analysts on behalf of Issuer C. During the question-and-answer portion of the meeting, an employee of Issuer C mentions that a large infrastructure project is significantly behind schedule. This information has not been disclosed to the marketplace broadly.

MSRB Recommendations and Resources

Selective disclosure is not new to the municipal market, and regulatory officials and various market stakeholders have also raised concerns with the practice.¹⁰ The MSRB is responding to the continuation of this practice with this market advisory by identifying concerns for investor protection and market integrity, and promoting the development and use of best practices to address them. While not required to comply with Regulation FD, municipal issuers may want to adopt the dissemination principles of the rule to address instances of selective disclosure should they occur.

The MSRB believes that the dissemination of timely, accurate and complete information about an issuer and its securities to all market participants is essential to a fair and efficient municipal market. Strong policies and procedures addressing disclosure practices could serve as helpful tools to ensure that information, both required and voluntary, is managed and disseminated appropriately. To avoid the potential regulatory consequences noted above, the MSRB suggests that issuers, and the dealers and municipal

¹⁰ See, e.g., Paul S. Maco, Director, Office of Municipal Securities (“OMS”), SEC, Securities Laws and the Municipal Issuer: Points for the Electronic Era (Sept. 13, 2000) (“The Commission does not believe that allowing issuers to disclose material information selectively is in the best interests of investors or the securities markets generally. The Commission wants all investors to compete on a level playing field and, to the maximum extent practicable, to have access to an issuer’s material disclosures at the same time.”); Martha Mahan Haines, Attorney-Fellow, OMS, SEC, Disclosure in the Municipal Market: Fundamental Concepts for Issuers (Sept. 19, 2000) (clarifying that, while Regulation FD does not apply to issuers of municipal securities, the rule may be a useful source of guidance for issuers as they contemplate how to disseminate material information to the public); National Federation of Municipal Analysts, Best Municipal Bond Issuance and Disclosure Practices 11 (2014) (noting its concern with selective disclosure of information to rating agencies, and recommending that all material information be included in the preliminary official statement and that additional nonmaterial information be posted voluntarily by issuers on the Electronic Municipal Market Access (EMMA®) website; Government Finance Officers’ Association (GFOA), Maintaining an Investor Relations Program (recommending the establishment of an investor relations program that, among other things, considers communication to all investors when a single investor poses a question).

advisors that serve them, refrain from selectively disclosing nonpublic material information.

The MSRB provides a [set of guiding principles for issuers seeking to enhance their disclosure practices](#) in the “Market Leadership” section of its website at MSRB.org.

The MSRB encourages issuers and their financial professionals to implement practices to ensure that all investors and stakeholders have equal access to the same information in a timely manner. For example, an issuer may choose to voluntarily disclose the information to the broader marketplace by a method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public. Although issuers could choose to utilize other means,¹¹ such a dissemination could be accomplished by posting the relevant information on EMMA. Based on the type of information, there are multiple options for how an issuer may choose to make such a voluntary disclosure. Two examples are provided below.

1. An issuer can associate pre-sale documents, such as a rating agency presentation or transcript of an investor meeting question-and-answer session, with a preliminary official statement of a bond issue that has yet to come to market. The online MSRB Education Center provides instructions for [posting a preliminary official statement](#) and associated pre-sale documents on EMMA.
2. An issuer can disseminate non-transaction-based material information to the marketplace on EMMA by posting a [voluntary continuing disclosure](#) and associating such disclosure with all of the issuer’s bonds. Issuers can choose from a preset list of voluntary disclosure types, or specify their own type of disclosure, and attach relevant supporting documents. See the [MSRB Education Center](#) for general disclosure tools and resources for state and local governments and other issuers.

¹¹ Many state and local governments maintain an investor relations website or other website on which they routinely disseminate information to the marketplace. In these cases, a state or local government may choose to also direct those seeking information about the issuer on EMMA to additional websites by adding a URL on their customized EMMA issuer homepage. Providing a link from EMMA to the issuer’s own webpage provides another channel to disseminate important information to the market. See the [MSRB Education Center includes instructions](#) for [how to post links on EMMA](#).