February 11, 2020

SEC Legal Bulletin: Antifraud Provisions Apply to Public Statements by Public Officials

On February 7, the Securities and Exchange Commission (SEC) provided a legal bulletin setting forth the views of the Office of Municipal Securities (the Office) regarding the application of the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder (collectively, the antifraud provisions) with respect to public statements made by issuers of municipal securities.[1] The Office indicated it issued the bulletin in response to questions raised about the application of antifraud provisions to statements of municipal securities issuers.

Antifraud Provisions

The antifraud provisions apply to the purchase and sale of municipal securities in the primary and secondary markets. They prohibit an issuer from making any untrue statement of a material fact or omitting 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 primary elements in determining whether there has been a violation of these provisions are ***scienter*** and ***materiality***.

Scienter

Scienter involves the intent to deceive, manipulate or defraud. However, the courts and the SEC have stated that scienter may be satisfied by a showing of recklessness. Recklessness is an extreme departure from the standards of ordinary care and involves the danger of misleading market participants known to the person making the statement, or so obvious that the official must have been aware of the possibility of misleading the market participants

Materiality

Under the antifraud provisions, a fact is material if there is a substantial likelihood that the information would have been viewed by the reasonable investor as having significantly altered the total mix of information available to an investor. Determining whether a statement is material is based on an analysis of facts and circumstances (a total mix analysis). The Office noted that it believes all statements of a municipal securities issuer that are reasonably expected to reach investors and trading markets are subject to the antifraud provisions even if the issuer is in compliance with its continuing disclosure undertakings. However, the total mix analysis may affect the materiality of a public statement made by an issuer and may depend on whether access to accurate, timely and comprehensive information about an issuer is "uneven and inefficient" rather than regularly available to investors through the MSRB's EMMA system or another investor-based communication vehicle such as an investor website.

Information Reasonably Expected to Reach Investors

The Office further noted that "information reasonably expected to reach investors" may be in the form of public announcements, press releases, interviews with media representatives and discussions with groups. The fact that the information is not published for purposes of informing the securities markets does not alter the mandate that it not violate the antifraud provisions. Information reasonably expected to reach investors includes the following:

Information on Websites

- Information needs to be accurate and not misleading.

- Historical information should be accurately reflected as such.
- Summaries should be accurately reflected as such, with layered links to more detailed information.
- Hyperlinks should be included with care as the information may be attributed to the issuer.
    - If an issuer was involved in the preparation of the hyperlinked information, the information may be attributed to the issuer.
    - If an issuer endorses or approves the hyperlinked information, it may be attributed to the issuer.
    - Issuers should add exit notices or intermediate screens before visitors enter the hyperlinked site, to minimize risk of attribution.
    - Issuers should add disclaimers to minimize the risk of attribution.

Public Reports Delivered to Other Governmental Bodies

- Comprehensive Annual Financial Reports (CAFRs)
- Budgets
- Mid-year financial reports
- Reports submitted by a municipality to a state agency
- Reports made by a state or local official to a legislative body (state legislature, city council, etc.)
- Reports made part of a public record and available to the public

Statements Made by Issuer Officials

"Officials" include those who may be viewed as having knowledge regarding the financial condition and operation of the issuer, and statements may include:

- Speeches
- Public announcements
- Interviews with media
- Statements disseminated through other avenues, including social media

Disclosure Policy and Procedures

Finally, the Office noted that proper disclosure policies and procedures, when consistently implemented, can benefit an issuer in its compliance with the antifraud provisions, and it encouraged issuers to adopt appropriate policies.

The attorneys in Day Pitney's Municipal Finance group routinely counsel clients on addressing compliance with the antifraud provisions and drafting disclosure policies and procedures. Please feel free to contact any of the attorneys listed to the right of this alert if you would like to discuss this alert, compliance with the antifraud provisions or drafting a disclosure policy.

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[1] The Bulletin can be found here. Note that the statements in the bulletin represent the views of the Office and the bulletin is not a rule, regulation or statement of the SEC and has no legal force or effect.

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