

**SECURITIES LAW PRESENTATION TO THE
BOARD OF REGENTS OF THE UNIVERSITY OF TEXAS SYSTEM**

Dallas, Texas
November 11, 1999

I. INTRODUCTION

- I have been asked to give you a brief overview of the Federal Securities laws as they relate to the UT System and its operations. As members of the Board of Regents, each of you has responsibilities and potential liabilities each time the UT System enters or speaks to the public debt markets.
- My name is Rick Porter, and I am one of the senior partners of McCall, Parkhurst & Horton L.L.P. My firm specializes in the area of public finance and represents many state agencies and political subdivisions in matters relating to their issuance of bonds and other securities. McCall, Parkhurst & Horton L.L.P. has represented the Board as Bond Counsel for a number of years and I have been primarily responsible for the UT System work since approximately 1986. We also advise the System on matters relating to the Federal Securities laws.
- As you are aware, bonds and notes issued for the UT System improvements are issued by and in the name of the Board of Regents.
- As a state agency, the Board is not generally subject to the regulatory requirements of the Federal Securities laws. This does not, however, relieve you of the responsibility to investors in the System's securities. The anti-fraud provisions of these laws apply to the System, the Board, including each of you individually, and to the staff and consultants.

II. The UT Board is a large participant in the public debt market with almost \$ 1.6 billion million in outstanding bonds and notes.

- (a) 1) The Board has two long term bond programs and two short term interim note programs. Notes in the short term programs are sometimes rolled over on a daily basis and the Board usually issues bonds two to four times a year.
- 2) Thus, the System is in the market frequently. The staff and consultants produce an official statement (prospectus) for each of the Bond issues, periodically update the offering memorandums for the note programs, and make annual and event filings in accordance with undertakings the Board has made with regard to the continuing disclosure of certain material information.

3) In addition, the research and other activities of the System produce situations where employees of the System or Board members may make statements which could influence the market for the Board's debt.

- (b) In each of these situations, there is an obligation to comply with the anti-fraud provisions of the securities laws and to make full and complete disclosure of all material information. It must be emphasized that the Board is under no obligation to make any disclosure unless it is engaged in the issuance of securities, has undertaken to make the disclosure, or has made previous disclosures about a subject which are no longer accurate.
- (c) Before proceeding, I want to emphasize that we believe that The University of Texas System has in place an excellent program to ensure compliance with the securities laws. Pam Clayton is one of the most qualified and diligent finance officers in the State and has an in depth understanding of your disclosure responsibilities. I also have great confidence in your General Counsel. We and the other firms representing you are regularly consulted on disclosure issues.

III. There have been many news stories over the last five years concerning wrongs in the public finance industry. Among those, there have been stories about:

- (a) bond defaults - Orange County, California and various developer financings;
- (b) SEC fraud allegations - Denver, Colorado, Maricopa County, Arizona, and 36 small towns in Mississippi;
- (c) yield burning; and
- (d) conflicts of interest and pay-to-play.

IV. How does this affect the Board? The Board and the staff must be aware of the law and the obligations it imposes on the Board and the System. The Securities and Exchange Commission (the "SEC") has 2 major initiatives which affect the Board:

- (a) The SEC has established an enforcement section devoted to municipal or public securities. The actions I mentioned above were handled by this new office.
- (b) And, it has taken steps to improve disclosure in the secondary market.
 - (i) In 1989 it adopted Rule 15c2-12 to the Securities and Exchange Act of 1934 and greatly expanded the Rule in 1994. The Rule governs what standards broker and dealers must meet before buying bonds or other securities issued by governmental bodies.
 - (ii) The Rule imposes three requirements:

1. The issuer must contractually undertake to the broker/dealer contracting to purchase the securities to furnish an official statement which the issuer deems final;
 2. The issuer must contract to annually provide during the life of the bonds (i) continuing disclosure of certain material information included in the official statement and (ii) the issuers annual financial statement; and
 3. It must also contract to promptly notify the purchasers in the event one of eleven events occurs. These include defaults, rating changes, draws on reserve funds or credit facilities, and similar occurrences.
 4. The issuer contracts to provide these annual and event disclosures by filing copies with what the SEC designated as nationally recognized municipal information repositories (NRMSIRS) and state information depositories (SIDS). There are currently four NRMSIRS and the Municipal Advisory Council of Texas has been designated the Texas SID.
- (c) Though the Board is exempt from the registration requirements of the Act and Rule 15c2-12 does not directly govern public entities such as the Board, when it makes the disclosures it has contracted to make it must comply with the anti-fraud provisions.

V. The Board is subject to the anti-fraud provisions of the Act.

- (a) Rule 10b-5 promulgated under Section 10b of the Act makes it "unlawful for any person, directly or indirectly, ... 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; or ... to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of a security."
- (b) The courts have determined that "[A] fact is material if there is a substantial likelihood that a reasonable (investor) would consider it important in deciding how to (act) ... 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."
- (c) Thus, the Board has a duty under the federal securities laws to produce bond disclosure documents that do not contain misstatements or omissions of "material" facts. Courts have also held that a fact is material "if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether to buy or sell bonds". Failure to meet these requirements could result in a Securities and Exchange Commission enforcement action or private litigation.

- VI. These provisions affect the operations of the System and the Board under 3 circumstances:
- (a) when bonds are issued or the offering memorandums relating to the note programs are updated;
 - (b) when the continuing disclosure documents are prepared and filed; and
 - (c) when an official or employee of the System becomes aware, in the course of his or her job or position, of non-public information which would be material to an investor.
- VII. The Board's obligation to meet the materiality standards when bonds are issued or the offering memorandums relating to the note programs are updated are met in the following manner:
- (a) in competitive transactions the official statement is usually prepared by the System staff in consultation with bond counsel;
 - (b) in negotiated transactions, the underwriter's counsel, as part of the underwriter's diligence obligations, usually prepares the official statement and it is then reviewed by bond counsel and staff; and
 - (c) the staff, in consultation with bond counsel and the dealer, is usually responsible for updating the note offering memorandums.
- VIII. The second circumstance when you need to be concerned with the antifraud rules is when the annual and material event continuing disclosure filings are made. The staff, in consultation with bond counsel have been responsible for these filings. The Board has made 3 material event filings: the first related to the amendment to the Master Resolution setting up the Revenue Financing System and the second one related to the rating upgrade of the Revenue Financing System bonds.
- IX. **In the case of all of these disclosures and filings and regardless of who it is prepared by, it is the Board's document.**
- (a) Though the SEC did not bring actions against the Orange County supervisors individually, in its report on Orange County it said:

"In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's

ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts."

- (b) You may rely upon your staff and consultants as long as you do not do so in a **reckless** manner. In the Orange County case, the SEC was of the opinion that the County Supervisors had actual knowledge that the County would be unable to meet its debt obligations.

X. The last circumstance when you need to be concerned with compliance with the securities laws involves insider trading.

- (a) The Board and each of the Regents, employees, and consultants are subject to the Insider Trading and Securities Fraud Enforcement Act of 1988 ("ITSFEA"). ITSFEA broadens the responsibility of employer entities, such as the Board, and their directors, officers or other supervising employees for actions of supervised employees and their tippees (i.e., persons receiving nonpublic information from a representative or employee of the System who had the intent such person would "trade" on such information for purchasing or selling securities while in possession of material nonpublic information).

The Act gives the SEC authority to impose by court action civil penalties and expands liabilities under private actions for insider trading. Specifically, the SEC may bring an action for civil penalties against an employer or its supervising employees as a result of trading by a controlled employee or such employees intended tippees. Not only is the entity subject to these penalties, but directors, officers, and other supervising personnel are also potentially at risk if those under their supervision violate the insider trading laws.

- (b) First, recognize that since we are dealing with bonds and not equities, the market is not as volatile. Thus, there is less likelihood that unintended disclosures will cause harm.
- (c) But harm can be caused. Each member of the Board and every employee and consultant must use judgment in making public statements and in sharing nonpublic "material information".
- (d) Everyone needs an awareness that if you come into possession of nonpublic material information, speak to general counsel about the appropriate method of handling the information.
- (e) These issues are made more difficult by the Open Records laws. This is a public institution and most of your records are open to the public. Thus, you need to be sensitive to what "material" information is available and decide if and when to make that information generally available to the entire market.

- (f) As I indicated previously, the Board does not always have a duty to disclose but when it does disclose, even through a member of the public coming into possession of material nonpublic information through the open records laws, it must act appropriately. These are often decisions for experts.

CONCLUSION

The UT System has a good program of securities law compliance. The Board must continue asking questions if circumstances arise which could be material.

- (a) Board members might want the audit committee to periodically review the disclosure documents.
- (b) Because of the increased activity of the SEC and the Board's large presence in the market, you should not be surprised if an inquiry regarding some financing occurs. You just need to respond appropriately and professionally.
- (c) Read the pamphlet "Questions to Ask Before You Approve A Bond Issue." Another good source of information is the brochure entitled "Bond ISSUES - Topics for the State of Texas Debt Issuing Community" prepared by the Texas Bond Review Board and the Texas State Auditor's Office. It may be found at the Texas Bond Review Board's web site and we have furnished copies to the Office of Finance.

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Send out to Regents when agenda material is mailed.
* Talk to Rick before we send out -
- Rick now also put together a brief outline -

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helpful as general info - 2 brochures -

These are Pam Clayton's notes - can disregard.