THE BOND BUYER

MSRB warns muni issuers, others about selective disclosure

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Published September 13 2017, 11:33am EDT

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PHOENIX - The Municipal Securities Rulemaking Board on Wednesday published a market advisory warning issuers and other municipal securities transaction participants against the practice of "selective disclosure."

Selective disclosure occurs when a municipal issuer makes information available to certain investors but not others. This can happen, for example, when non-public material information is presented during road shows, investor conferences and one-on-one investor calls or meetings.

Selective disclosure can also occur in the secondary market, the MSRB said, where 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 or any other rule, to select investors or analysts..

Material information generally has been defined under case law to mean there is a substantial likelihood that it would be considered important by a reasonable investor making an investment decision.

Selective disclosure can hamper fairness in the muni market, MSRB executive director Lynnette Kelly said.

The MSRB, which does not have regulatory authority over issuers but says its mission is, in part, to protect issuers and provide them with information, said that while smaller investor meetings can be fine they can raise selective disclosure and market fairness issues by appearing to favor some bondholders over others.

“Issuers of municipal securities and their financial professionals share a responsibility to protect the integrity of the municipal market by making full and fair disclosures to all investors,” said MSRB executive director Lynnette Kelly. “When selective disclosure occurs – often inadvertently – certain investors can be disadvantaged.”

”The MSRB is a resource for issuers and their financial professionals seeking to implement practices to ensure that all investors and stakeholders have equal access to the same material information from the issuer in a timely manner,” she added.

The Securities and Exchange Commission’s Regulation Fair Disclosure explicitly prohibits selective disclosure in the corporate market, but muni issuers are not bound by that rule.

However, the MSRB warned that issuers face the potential for fraud charges if known material information is omitted from required public disclosures. Investors can also face insider trading charges if they make trades based on material nonpublic information.

The MSRB cautioned that, while disclosure is considered an issuer responsibility, dealers acting as underwriters and municipal advisors often also play roles in it and could face consequences if selective disclosure rises to the level of fraud.

“This liability could include aiding and abetting or causing the issuer’s violations, or their own direct violations, the board said in its advisory.

In addition, any selective disclosure that creates potential liability under the Securities Act of 1933 and the Securities Exchange Act of 1934 could similarly trigger potential violations by dealers or municipal advisors under MSRB Rule G-17, which requires that they deal fairly with all persons and not engage in any deceptive, dishonest or unfair practices. The rule contains an antifraud prohibition similar to the standard set forth in the Securities Exchange Act; however, it also establishes a general duty to deal fairly, even in the absence of fraud.

The MSRB advisory provided three examples to highlight instances where selective disclosure could occur.

It is common for a lawyer to review a transcript of a road show or investor call to be sure that no information conveyed that isn't available to the public through another means, the MSRB said.

The board stressed that its advisory is not aimed at discouraging direct communications between issuers and investors or analysts.

The advisory encouraged issuers and their finance teams to implement policies and practices to ensure that all investors and stakeholders have equal access to the same information in a timely manner. The MSRB said, for example, that issuers can post bond-related material information on its EMMA system and gave some examples of how an issuer might do so. In addition, the board said it has a set of guiding principles for issuers seeking to enhance their disclosure practices in the Market Leadership section of its website, MSRB.org