Secondary Market Disclosures

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Learning Objectives

1. Familiarity with the requirements of the Municipal Advisor Rules which came into effect on July 1.

2. Learn about the MCDC Initiative.

Dodd-Frank Act

"With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the MSRB was expressly directed by Congress to protect municipal entities."

MSRB Notice 2011-38 (August 22, 2011)

Dodd-Frank Act cont)

15 USC Sec. 78o-4(b)(2), as amended by Dodd-Frank:

The Board shall propose and adopt rules to effect the purposes of this chapter with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers and municipal advisors. ~~(Such rules are hereinafter collectively referred to in this chapter as "rules of the Board".)~~ The rules of the Board, as a minimum, shall:

(A) provide that no municipal securities broker or municipal securities dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security and no broker, dealer, municipal securities dealer, or municipal advisor shall provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities unless such municipal securities broker or municipal securities dealer meets such standards of operational capability and such municipal securities broker or municipal securities dealer and every natural person associated with such municipal securities broker or municipal securities dealer meet such standards of training, experience, competence, and such other qualifications as the Board finds necessary or appropriate in the public interest or for the protection of investors and municipal entities or obligated persons.

MSRB Rule G-17

MSRB Rule G-17 is also known as the “duty of fair dealing” rule.

Pre-Dodd Frank, it read:

Rule G-17: Conduct of Municipal Securities Activities

In the conduct of its municipal securities activities, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice.

Post-Dodd-Frank, it reads:

Rule G-17: Conduct of Municipal Securities and Municipal Advisory Activities

In the conduct of its municipal securities or municipal advisory activities, each broker, dealer, ~~and~~ municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice.

MSRB Rule G-17 Interpretive Notice

Overview: Underwriters must disclose, in writing, to their state and local government clients, risks about complex financial transactions, potential conflicts of interest, compensation, and other matters. These disclosures must be made to an official of the issuer that the underwriter reasonably believes has the authority to bind the issuer by contract with the underwriter and must be made in a manner designed to make clear to such official the subject matter of the disclosures, their implications for the issuer, and in sufficient time to allow the official to evaluate the recommendation. The Interpretive Notice also provides specific examples intended to assist underwriters in determining how to ensure that they have provided state and local governments with the information to allow them to make informed decisions about issuing bonds and related transactions.

The “New” Municipal Advisor Rule(s)

1. Section 975 of the Dodd-Frank Act amended Section 15B of the Securities Exchange Act of 1934 to add a new requirement that “municipal advisors” register with the SEC, starting October 1, 2010.
2. On December 20, 2010, the SEC issued proposed rules.
3. On September 12, 2011, the MSRB withdrew most of its pending Municipal Advisor Rule proposals until the SEC adopted a “permanent definition” of the term, “municipal advisor.”
4. On September 18, 2013, the SEC adopted final municipal advisor registration rules, which were to become effective on January 13, 2014
5. On January 9, 2014, the MSRB requested comments on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors (comments due March 10, 2014).
6. On January 10, 2014, the SEC’s Office of Municipal Securities provided general interpretive guidance on certain aspects of the rules.
7. On January 13, 2014, the SEC delayed the compliance date until July 1, 2014.
8. On May 19, 2014, the SEC’s Office of Municipal Securities provided additional general interpretive guidance on certain aspects of the rules.
9. On July 1, 2014, the final municipal advisor registration rules became effective.
10. On July 15, 2014, the MSRB confirmed that t was re-proposing draft MSRB Rule G-42.

The “New” Municipal Advisor Rule(s) cont)

What is a municipal advisor?

A person that (1) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products (municipal derivatives, GICs and investment strategies) or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or (2) undertakes a solicitation of a municipal entity.

Includes financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and swap advisors

Does not include a broker, dealer or municipal securities dealer serving as an underwriter, any investment adviser (or associated persons) registered under the Investment Advisers Act of 1940, any commodity trading advisor (or associated persons) registered under the Commodity Exchange Act, attorneys providing legal advice or providing services that are of a traditional legal nature, or engineers providing engineering advice.

The “New” Municipal Advisor Rule(s) cont)

What is “advice”

First, advice depends on all of the relevant “facts and circumstances.”

Second, advice includes certain “recommendations” that are particular to the specific needs, objectives, or circumstances of a municipality. Note that whether a “recommendation” has been made is an objective, not subjective inquiry, i.e., whether, considering its content, context and manner of presentation, the information communicated to the municipal entity or obligated person reasonably would be viewed as a suggestion that the municipal entity or obligated person take action or refrain from taking action regarding municipal finance products or the issuance of municipal securities.” Q 1.1, SEC FAQ, 1/10/14.

Third, advice does not include certain “general information” (for example, facts without opinions or educational materials). (Also referred to as the “general information exclusion”)

The “New” Municipal Advisor Rule(s) cont)

A municipal advisor owes a “fiduciary duty” to its municipal clients to act in their best interests.

“A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor’s fiduciary duty or that is in contravention of any rule of the Board.”

Note: A fiduciary duty is not owed to “obligated person” clients; only a duty of “fair dealing” under MSRB Rule G-17.

Business Conduct

What Does an IRMA Do?

Proposed MSRB Rule G-42 addresses this question, and also discusses the standard of fiduciary duty.

"Under draft Rule G-42 (a), each municipal advisor in the conduct of its municipal advisory activities on behalf of a municipal advisory client is subject to a fiduciary duty, which includes, without limitation, a duty of care and a duty of loyalty."

Fiduciary Duty

Duty of Care

Municipal advisor must

(a) Exercise due care in performing its municipal advisory activities
(b) Possess the degree of knowledge and expertise needed to provide the client with informed advice
(c) Make a reasonable inquiry as to the facts that are relevant to a client's determination as to whether to proceed with a course of action or that form the basis for any advice provided to the client
(d) Undertake a reasonable investigation to determine that the municipal advisor is not basing any recommendation on materially inaccurate or incomplete information.

"In addition, a municipal advisor that is engaged by a client in connection with either an issuance of municipal securities or a municipal financial product that is related to an issuance of municipal securities must also undertake a thorough review of the official statement for that issue unless otherwise directed by the client and so documented in writing."

Duty of Loyalty

A municipal advisor must deal honestly and with the utmost good faith with a municipal entity client and act in the client's bests interests without regard to the financial or other interests of the municipal advisor.

Exclusions and Exemptions

The exemptions focus on particular exempted “activities” rather than on the “status” (for example, accountants, attorneys) of the market participant.

Public Official and Employee (as long as acting within scope of their official or employment capacity).
Underwriter (covers advice on the issuance of municipal securities from the time of engagement as underwriter on a particular transaction through the end of the underwriting period)
RFP Process
Independent Registered Municipal Advisor
Registered Investment Advisors
Registered Commodity Trading Advisors
Banks (for traditional banking activities)
Professionals (Attorneys, Accountants and Engineers)
“General Information”

IRMA Exemption

Requirements:

1. The IRMA must be a person that is registered as a municipal advisor and that is not, and within at least the past two years was not, associated with the person seeking to use the exemption.

2. The person seeking to use the exemption must receive a written representation from the municipal entity or obligated person that the municipal entity or obligated person is represented by, and will rely on the advice of, the IRMA. The person seeking to use this exemption must have a reasonable basis for relying on this representation.

3. The person seeking to use this exemption must provide written disclosures to the municipal entity or obligated person, with a copy to the IRMA, stating that the person is not an IRMA and is not subject to the fiduciary duty to municipal entities imposed on IRMAs. This disclosure must be made at a time and in a manner reasonably designed to allow the municipal entity or obligated person to assess the material incentives and conflicts of interest that such person may have in connection with the municipal advisory activities.

Underwriter Exclusion

The engagement letter may have reasonable conditions or limitations under the circumstances. For example:

1 A statement that the engagement is preliminary in nature and that the issuer intends or reasonably expects to engage the broker-dealer as the underwriter for an identified issue of municipal securities.

2. A statement that the engagement is subject to conditions, such as formal approval of the selection of the underwriter by the governing body or finalizing the structure of the issue of municipal securities.

3. A statement that the engagement is nonbinding and that it can be terminated by either party.

4. A term that limits liability of a party to the engagement letter.

Note: A municipal entity or obligated person can furnish engagement letters to more than one underwriter, provided that it reasonably expects to engage each such underwriter to serve as an underwriter on the identified issue of municipal securities. Q 5.1, SEC FAQ 1/10/14.

RFP/RFQ Exemption

In the SEC staff's view, an RFP/RFQ with the following parameters is consistent with the requirements of the RFP exemption:

(a) The municipal entity or obligated person, or an IRMA acting on their behalf, conducts the RFP/RFQ

(b) A particular objective is identified in the RFP/RFQ (for example, how to structure a deal to finance a project)

(c) The RFP/RFQ is open for a specific period of time that is reasonable under the facts and circumstances and is not indefinite

(d) The RFP/RFQ involves a competitive process (i.e., sent to at least three reasonably competitive market participants or is posted on the official website).

"In the staff's view, an RFP or RFQ does not need to be part of a municipal entity's formal procurement process to be consistent with the requirements of the RFP exemption." Q 2.1, SEC FAQ (1/10/14)

SIFMA (Securities Industry and Financial Markets Association) Municipal Advisor Model Documents

Released May 7, 2014

1. Model Negative Consent/Affirmative Consent Certificates Relating to Bond Proceeds
2. Model Disclosures and Disclaimers for General Information Exclusion and Business Promotional Materials
3. Model IRMA Exemption Language
4. Model IRMA Confirmation Language
5. Model RFP Language
6. Model Engagement Letters

Review of 2013 Enforcement

In the Matter of the City of Harrisburg, Pennsylvania, SEC Rel. No. 34-69515 (May 6, 2013) - Order Instituting Cease-and-Desist Proceedings

Importance: Harrisburg marks the first time that the SEC charged a municipality for misleading statements made outside of its securities disclosure documents.

Facts: City failed to comply with its continuing disclosure requirements from 2009-2011.

Result: Investors had to seek out the City's other public statements in order to obtain current information about the City's finances. However, there was not much information publicly available elsewhere, and information that was accessible on the City's website either misstated or failed to disclose critical information about the City's financial condition and credit ratings. Because of these misrepresentations, secondary market investors made trading decisions based on inaccurate and stale information.

Lesson: Statements that are reasonably expected to reach the securities market, even if not prepared for that purpose, cannot be materially misleading.

Review of 2013 Enforcement cont)

Section 21 (a) Report of Investigation in the Matter of the City of Harrisburg, Pennsylvania Concerning the Potential Liability of Public Officials, SEC Rel. No. 34-69516 (May 6, 2013)

Importance: Section 21 (a) reports are rare. The SEC uses these reports as a vehicle to signal how it views a particular problematic area or set of practices - so they are essentially policy statements. Perhaps more importantly, they put people on notice that going forward, the SEC and its Enforcement Division will consider similar conduct to be fair game for more conventional enforcement action.

Why: Based upon information obtained during the investigation, the Commission deemed it appropriate that it issue this Report to address the obligations of public officials relating to their secondary market disclosures for municipal securities. Public officials should be mindful that their public statements, whether written or oral, may affect the total mix of information available to investors, and should understand that these public statements, if they are materially misleading or omit material information, can lead to potential liability under the antifraud provisions of the federal securities laws.

Lesson: Issuers and other municipal market participants should follow and further develop voluntary industry initiatives to enhance disclosure policies and procedures for both primary offering and ongoing disclosures. Such initiatives may include the adoption of issuer disclosure committees and training programs.

Review of 2013 Enforcement (cont)

In the Matter of West Clark Community Schools, SEC Rel. No. 33-9435, 34-70057 (July 29, 2013) - Order Instituting Cease-and-Desist Proceedings

Importance: West Clark marks the first time that the SEC charged a municipal issuer with falsely claiming in a bond offering's official statement that it was fully compliant with the annual disclosure obligations it agreed to in prior offerings.

Facts: An official statement prepared in 2007 for a bond offering on behalf of the school district falsely stated that it was in compliance with its disclosure obligations related to prior bond offerings.

Result: The school district undertook remedial actions including the adoption of written policies for its continuing disclosure obligations and the designation of an individual responsible for ensuring compliance with those obligations. The school district also implemented annual training for personnel involved in the bond offering and disclosure process.

Lesson: West Clark defrauded bond investors by leading them to believe that it had provided the annual financial information contractually required in a prior bond offering, when, in fact for five years they failed to submit the required information. "This case demonstrates that [the SEC] will be vigilant in making sure municipal issuers and underwriters comply with their obligations."

Review of 2013 Enforcement cont)

In the Matter of the Greater Wenatchee Regional Events Center Public Facilities District, Alison Williams, Global Entertainment Corporation, and Richard Kozuback, SEC Rel. No. 33-9471 (November 5, 2013) - Order Instituting Cease-and-Desist Proceedings

Importance: It is the first time that the SEC has assessed a financial penalty against a municipal issuer.

Facts: The district, which was a municipal corporation formed by nine Washington cities and counties to fund the Toyota Town Center, issued BANs in 2008 and defaulted on these in 2011. The official statement contained inaccuracies and omissions.

Result: The district settled the SEC's charges by paying a $20,000 penalty and undertaking remedial actions,

Lesson: Financial penalties against municipal issuers are appropriate for sanctioning and deterring misconduct when they can be paid from operating funds without directly impacting taxpayers. The SEC considers the penalty "an appropriate price for withholding negative information from its primary offering document and giving investors a false picture of the future performance of the project."

SEC Rule 15c2-12

(b)(5)(i): A Participating Underwriter shall not purchase or sell municipal securities in connection with an Offering unless the Participating Underwriter has reasonably determined that an issuer of municipal securities, or an obligated person for whom financial or operating data is presented in the final official statement has undertaken, either individually or in combination with other issuers of such municipal securities or obligated persons, in a written agreement or contract for the benefit of holders of such securities, to provide:

(A) Annual financial information for each obligated person

(B) If not submitted as part of the annual financial information, then when and if available, audited financial statements

(C) Notice of events

(D) Notice of failure to provide required annual financial information.

SEC Rule 15c2-12 cont)

(b)(5)(ii) The written agreement or contract for the benefit of holders of such securities also shall identify each person for whom annual financial information and notices of material events will be provided, either by name or by the objective criteria used to select such persons, and, for each such person shall:

(A) Specify, in reasonable detail, the type of financial information and operating data to be provided as part of annual financial information;

(B) Specify, in reasonable detail, the accounting principles pursuant to which financial statements will be prepared, and whether the financial statements will be audited; and

(C) Specify the date on which the annual financial information for the preceding fiscal year will be provided, and to whom it will be provided.

SEC Rule 15c2-12 (cont)

(f)(3) The term final official statement means a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth…a description of the undertakings to be provided pursuant to paragraph (b)(5)(i).. and of any instances in the previous five years in which each person specified pursuant to paragraph (b)(5)(ii) of this section failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of this section.

Underwriter "Due Diligence" on Continuing Disclosure

The "Reasonable Belief Standard:" The underwriter must have a "reasonable belief" in the accuracy and completeness of the key representations in the issuer's official statement, including its obligation to disclose any failures in the prior five years to materially comply with prior continuing disclosure undertakings.

How must the underwriter reach a "reasonable belief" as to this topic?

"Critical to the evaluation of a covenant is the likelihood that the issuer or obligated person will abide by the undertakings. The definition of final official statement thus has been modified to require disclosure of all instances in the previous five years in which any person providing an undertaking failed to comply in all material respects with any previous informational undertakings called for by the amendments. This information is important to the market, and should, therefore, be disclosed in the final official statement. The requirement should provide an additional incentive for issuers and obligated persons to comply with their undertakings to provide secondary market disclosure, and will ensure that Participating Underwriters and others are able to assess the reliability of disclosure representations." The 1994 Adopting Release at n. 52.

"In the Commission's view, it…is doubtful that an underwriter could meet the reasonable belief standard without the underwriter affirmatively inquiring as to that filing history. The underwriter's reasonable belief should be based on its independent judgment, not solely on representations of the Issuer or obligated person as to the materiality of any failure to comply with any prior undertaking." See 2010 Adopting Release.

March 10, 2014 – The MCDC Initiative

On Monday, March 10, the SEC announced the Municipalities Continuing Disclosure Cooperation Initiative ("MCDC Initiative"). Under the MCDC Initiative, the SEC's Division of Enforcement ("Enforcement") will recommend favorable settlement terms to issuers (including obligated persons) and underwriters involved in municipal securities offerings, if they self-report to Enforcement possible violations involving materially inaccurate statements relating to prior compliance with their continuing disclosure obligations. Parties taking advantage of the MCDC Initiative will need to complete a form questionnaire available online and submit it by no later than 12 AM, September 10, 2014 (i.e., September 9, 11:59 PM), and agree to consent to standard settlement terms.

The MCDC Initiative cont)

The MCDC Initiative is targeted to issuers that have made materially inaccurate statements in a final official statement regarding their prior compliance, as well as lead underwriters of underwriting syndicates (or sole underwriters) for both competitive and negotiated offerings in which the final official statement contains materially inaccurate statements regarding an issuer's prior compliance. To the extent that Enforcement determines to recommend an enforcement action against an eligible issuer or underwriter under the MCDC Initiative, Enforcement will then recommend to the Commission that it accept a settlement which includes the following terms:

1. Eligible issuers and underwriters will consent to a cease-and-desist proceeding for violation of Section 17(a)(2) of the Securities Act of 1933, and will not be required to admit or deny the Commission's findings.

2. Issuers must undertake to (a) establish appropriate continuing disclosure policies and procedures and training within 180 days of the institution of the proceedings; (b) comply with existing continuing disclosure undertakings, including updating prior delinquent filings, within 180 days of the institution of the proceedings; (c) cooperate with any subsequent investigation by Enforcement regarding the false statements, including the roles of individuals and/or other parties involved; (d) disclose in a clear and conspicuous fashion the settlement terms in any final official statement for an offering by the issuer within five years of the date of the institution of the proceedings; and (e) provide the Commission staff with a compliance certification regarding the applicable undertakings by the issuer on the one year anniversary of the date of institution of the proceedings.

The MCDC Initiative cont)

3. Issuers will not pay civil penalties; underwriters have a graduated civil penalty payment scale depending on the par amount of the offering, but will not have to pay more than $500,000 in total under the MCDC Initiative.

4. The MCDC Initiative only covers eligible issuers and underwriters. Enforcement may recommend enforcement actions and remedies against municipal officials and underwriter employees that are not covered by the MCDC Initiative.

5. Eligible issuers and underwriters who do not take advantage of MCDC Initiative may not be offered the same terms in subsequent non-MCDC Initiative enforcement actions. Issuers should expect financial sanctions.

The MCDC Initiative cont)

"We encourage eligible parties to take advantage of the favorable terms we are offering," Andrew Ceresney, director of the SEC's enforcement division, stated. "Those who do not self-report and instead decide to take their chances can expect to face increased sanctions for violations."

"It could be a very effective and efficient tool by the SEC," said Elaine Greenberg, the former head of the SEC enforcement division that pursued municipal bond cases and now a partner with Orrick, Herrington and Sutcliffe LLP in Washington. "During only six months in the program, it could capture exponentially more violations than the SEC's limited investigator resources would allow."

The SEC's Position

At a conference of bond attorneys at the end of March, the new chief of the SEC's Municipal Securities Enforcement Unit stated that the MCDC Initiative was deliberately written in a way to create a tension between underwriters and issuers, or what she called, "a modified prisoner's dilemma."

"Needless to say, if one party self-reports and the other does not, a problem arises for the second party if the SEC staff determines that the facts warrant an enforcement action. The SEC looks at this tension as a way to incentivize more and fuller disclosures." – Orrick SEC Alert, Update on Municipalities Continuing Disclosure Cooperation Initiative, April 9, 2014.

Other "lessons:" (1) Underwriters cannot rely on issuer certifications and (2) Not disclosing prior compliance is the same thing as saying that you were previously compliant.

The MCDC Questionnaire

MUNICIPALITIES CONTINUING DISCLOSURE COOPERATION INITIATIVE
QUESTIONNAIRE FOR SELF-REPORTING ENTITIES

1. Please provide the official name of the entity that is self-reporting ("Self-Reporting Entity") pursuant to the MCDC Initiative along with contact information for the Self-Reporting Entity:

   Individual Contact Name:
   Individual Contact Title:
   Individual Contact telephone:
   Individual Contact Fax number:
   Individual Contact email address:

   Full Legal Name of Self-Reporting Entity:
   Mailing Address (number and street):
   Mailing Address (city):
   Mailing Address (state):
   Mailing Address (zip):

The MCDC Questionnaire cont)

2. Please identify the municipal bond offering(s) (including name of Issuer and/or Obligor, date of offering and CUSIP number) with Official Statements that may contain a materially inaccurate certification on compliance regarding prior continuing disclosure obligations (for each additional offering, attach an additional sheet or separate schedule):

   State:
   Full Name of Issuing Entity:
   Full Legal Name of Obligor (if any):
   Full Name of Security Issue:
   Initial Principal Amount of Bond Issuance:
   Date of Offering:
   Date of final Official Statement (format MMDDYYYY):
   Nine Character CUSIP number of last maturity:

The MCDC Questionnaire cont)

3. Please describe the role of the Self-Reporting Entity in connection with the municipal bond offerings identified in Item 2 above (select Issuer, Obligor or Underwriter):

☐ Issuer
☐ Obligor
☐ Underwriter

The MCDC Questionnaire cont)

4. Please identify the lead underwriter, municipal advisor, bond counsel, underwriter's counsel and disclosure counsel, if any, and the primary contact person at each entity, for each offering identified in Item 2 above (attach additional sheets if necessary):

   Senior Managing Underwriting Firm:
   Primary Individual Contact at Underwriter:

   Financial Advisor:
   Primary Individual Contact at Financial Advisor:

   Bond Counsel Firm:
   Primary Individual Contact at Bond Counsel:

   Law Firm Serving as Underwriter's Counsel:
   Primary Individual Contact at Underwriter's Counsel:

   Law Firm Serving as Disclosure Counsel:
   Primary Individual Contact at Disclosure Counsel:

The MCDC Questionnaire cont)

5. Please include any facts that the Self-Reporting Entity would like to provide to assist the staff of the Division of Enforcement in understanding the circumstances that may have led to the potentially inaccurate statements (attach additional sheets if necessary):

On behalf of ,
I hereby certify that the Self-Reporting Entity intends to consent to the applicable settlement terms under the MCDC Initiative.

By: _____
Name of Duly Authorized Signer:
Title:

MCDC – Issuer Considerations

Analysis of the Initiative (from the Hawkins Advisory, April 11, 2014 Special Edition, "SEC's Enforcement Division Announces its Municipalities Continuing Disclosure Cooperation Initiative").

Issuers should determine whether each of their official statements published within the last five years accurately described the status of their compliance with their continuing disclosure agreements. To emphasize, it is not a matter of whether issuers complied with their continuing disclosure agreements, but rather whether they stated in their official statements that they were in compliance in all material respects when they were not. The interplay between the general antifraud provisions and the definition of "final official statement" in Rule 15c2-12 suggests the following analysis for a municipal issuer when considering whether to "self-report" under the Initiative:

MCDC – Issuer Considerations cont)

First – If an issuer had been in compliance with its continuing disclosure agreements in all material respects, there was no need to say anything on this point in its final official statements.

Second – If an issuer was not in compliance with its continuing disclosure agreements in all material respects and it accurately disclosed such failures in its final official statements, the issuer satisfied its securities law obligations.

Third – if the issuer stated in its final official statements that it had been in compliance in all material respects when in fact it had not, this could result in securities law liability if there were a material misstatement. Accordingly, in this instance an issuer should carefully consider whether to "self-report," and in reaching that decision whether or not to discuss this issue with the underwriter.

Fourth – if the issuer did not comply with its continuing disclosure obligations but the final official statements included no disclosure at all regarding compliance or non-compliance, as a purely legal matter, such omission may not have been a violation by the issuer of the general antifraud provisions, which require that any omission must make the statements that were made misleading. On the other hand, undisclosed failures would result in the "final official statement" not meeting the definition of such term in Rule 15c2-12. In such instances, the underwriter may be "self-reporting" such failures.

MCDC – Practical Approach

From the Orrick SEC Alert:

1. Given the SEC's current heightened scrutiny of this area, it would be prudent for issuers to undertake an internal review of their past compliance with their continuing disclosure obligations. This can include:

a. Filing of annual financial reports, including the audited financial statements, in a timely manner and with the correct filing location (since July 2009, this will have been the EMMA website operated by the Municipal Securities Rulemaking Board). A review should also be made to verify that the reports contain the correct financial and operating information (e.g., correct tables) as well as the audit.

b. Reports of material events, particularly rating downgrades

Based on a self-examination, or information received from an underwriter, if there have been continuing disclosure lapses (large or small), the issuer should identify any official statement in the past five years where the lapse might not have been disclosed.

MCDC – Practical Approach cont)

2. However, issuers should be aware that underwriters will have an incentive to report virtually any lapse in compliance, so issuers may find themselves exposed to the "prisoner's dilemma" if they limit the scope of their review of their own practices. Alternatively, they can wait to see if an underwriter "reports" them (assuming the underwriter will notify the issuer ahead of time), but if the underwriter's report is filed on September 9, 2014, the issuer will be out of time. Issuers have the option to reach out to their underwriters to ask if the underwriter has become aware of any continuing disclosure lapses by the issuer.

3. If lapses are discovered or known, and were not disclosed in an official statement during the past five years, a decision will have to made as to whether or not to self-report under the MCDC Initiative. A first consideration is whether the lapses in any way approach a level of materiality. This can be discussed with internal or external securities counsel. If there appears to be any reasonable case that the lapse(s) might be treated as a material failure to comply with a continuing disclosure undertaking, the issuer should seriously consider self-reporting. As noted in the memorandum, an issuer can self-report and then argue to the SEC staff that no enforcement action is warranted. If the SEC disagrees, the consequences of self-reporting for an issuer are not burdensome. For example, it is prudent for an issuer to have written continuing disclosure policies and procedures in any event. The greatest downside to self-reporting is the potential for adverse publicity (and we recognize this can be an important issue for public officials), and the requirement to disclose the terms of the cease and desist settlement with the SEC for five more years. However, as noted above, the "prisoner's dilemma" presents the issuer with a much harsher regime if the underwriter reports the issuer's lapse(s) and the SEC decides they were material.

MCDC – Practical Approach cont)

4. If after considering all these factors an issuer decides to self-report, it would be good practice to notify the underwriter ahead of the submission, along with the other parties who have to be identified in the SEC Questionnaire (such as bond, disclosure and underwriter's counsel and the financial advisor).

5. One situation which may arise is that an issuer discovers a lapse(s) in prior compliance, but the issuer has not sold any bonds since that time (so there would be nothing to report under the MCDC Initiative). In that case the issuer should definitely correct the lapse(s) with additional filings on EMMA, and then be prepared to discuss the circumstances in their next official statement.

MCDC – Issuer Considerations - Commentary

"Clearly, any material misstatements or omissions merit serious consideration for "self-reporting." On the other hand, it would appear to serve no purpose to "self-report" pursuant to the Initiative all failures to comply with prior agreements, without regard to materiality. Rule 15c2-12(b)(5)(i)(D) requires that notice be provided of any failure to provide required annual financial information when due. In contrast, Rule 15c2-12's definition of "final official statement" requires disclosures of failures to "comply, in all material respects, with any previous undertakings." Thus, Rule 15c2-12 recognizes that not all failures are material. Accordingly, cooperation between issuers and underwriters in determining whether the legal standard was satisfied is appropriate."

- Hawkins Advisory

MCDC – Issuer Considerations – Commentary cont)

"Finally, it would be very useful for the Division to provide some guidance as to what standard it expects to use to determine a minimal threshold of variance from full literal compliance below which "self-reporting" under the Initiative would not be expected, consistent with the use of the phrase "in all material respects" in Rule 15c2-12's definition of "final official statement." Although the SEC staff has a long-standing policy of not providing specific guidance as to what is "material" in the context of the general antifraud provisions (i.e., substantive materiality), in this instance the guidance would be with respect to a definition in an SEC rule (i.e., procedural materiality). Such guidance could address common occurrences, such as, for example, those instances of (i) incorrect CUSIP numbers for a few maturities of bonds, and (ii) failures to file notices of rating changes during the financial crisis when rating changes occurred rapidly without notice to the issuer."

- Hawkins Advisory

MCDC Issuer – Best Practices

The Issuer Undertaking:

Issuers must undertake to (a) establish appropriate continuing disclosure policies and procedures and training within 180 days of the institution of the proceedings; (b) comply with existing continuing disclosure undertakings, including updating prior delinquent filings, within 180 days of the institution of the proceedings; (c) cooperate with any subsequent investigation by Enforcement regarding the false statements, including the roles of individuals and/or other parties involved; (d) disclose in a clear and conspicuous fashion the settlement terms in any final official statement for an offering by the issuer within five years of the date of the institution of the proceedings; and (e) provide the Commission staff with a compliance certification regarding the applicable undertakings by the issuer on the one year anniversary of the date of institution of the proceedings.

2014 Enforcement – The First MCDC Initiative Case

In the Matter of Kings Canyon Joint Unified School District, SEC Rel. No. 33-9610 (July 8, 2014) - Order Instituting Cease-and-Desist Proceedings and Imposing Remedial Sanctions

Importance: This case is the first to be resolved under the MCDC Initiative.

Facts: In a 2010 bond offering, the School District "affirmatively stated…that it had not failed, in the previous five years, to comply in all material respects with any prior continuing disclosure undertakings. This was an untrue statement of a material fact."

Result: The school district consented to a cease-and-desist order and agreed to adopt written policies for its continuing disclosure obligations, comply with its existing continuing disclosure obligations, cooperate with any subsequent investigation by the Enforcement Division, and disclose the terms of its settlement with the SEC in future bond offering materials.

Lesson: Still to be determined…

Lessons from Kings Canyon

From the July 9, 2014 Bond Buyer, “Muni Market Frustrated by Vague MCDC Settlement”

Bond lawyers and issuers are frustrated that the Securities and Exchange Commission did not specify the disclosure failures that led to its settlement with a California school district on Tuesday. They said it leaves them with no helpful guidance on what kinds of disclosures the SEC is focusing on in its Municipalities Continuing Disclosure Cooperation voluntary enforcement initiative.

Lawyers, issuers, and underwriters have all said it would be helpful to know what level of disclosure failure and subsequent omission would be of interest to the SEC. But the commission has been tight-lipped on that front and SEC officials have suggested that guidance of that sort would not serve the purposes of the MCDC.

"Maybe that's the SEC's intent," said a lawyer who preferred not to be identified. "Maybe they want everyone to be afraid.”

"I get no benefit from this enforcement proceeding," said Ben Watkins, chairman of the Government Finance Officers Association's debt committee and Florida's bond finance director. Watkins has been an outspoken critic of the SEC's approach, and GFOA has joined with other market groups to suggest changes to the program, including extending it beyond the Sept. 10. Some groups also asked the program be restricted to deals that occurred after EMMA became the sole repository for continuing disclosures in 2009.

Watkins said the SEC should be letting issuers focus on whatever the commission truly deems important, rather than letting public officials search through difficult-to-navigate pre-EMMA data looking for the smallest disclosure failures.

"Their focus is on punishing people," he said.

Lessons from Kings Canyon cont)

Paul Maco, a partner at Bracewell & Giuliani LLP, said the SEC passed on providing the specificity sought by Watkins and other market participants.

"The SEC clearly had an opportunity in this settled proceeding to address the scope of responses expected with respect to MCDC reporting, and chose not to send any signal or other indication beyond what they've already provided," Maco said.

John McNally, a partner at Hawkins Delafield & Wood LLP, said the SEC's decision to leave the specific disclosure failures unspecified will not aid market participants working against the clock to participate in the MCDC.

"As noted in the GFOA's recent alert, the SEC enforcement division has been unwilling to provide any general guidance regarding what is not material for purposes of the MCDC initiative," McNally said. "Without regard to the merit of that position, this order was an opportunity to provide some specific guidance and the SEC chose not do so, stating only that 'the issuer failed to submit some of the disclosures required.' It is difficult to understand the SEC's rationale, and as issuers and underwriters work to meet the tight deadline of two months from today this order provides no help."

What Were the Facts?

For FY 2003: 19 days late
For FY 2004: 12 days late
For FY 2005: On time
For FY 2006: 20 days late
For FY 2007: 18 days late
For FY 2008: On time with AFS, 76 days late with operating data
For FY 2009: 465 day late with AFS, 765 days late with operating data (note: filed after 2010 OS)

2010 Disclosure: “The District has had no instance in the previous five years in which it failed to comply in all material respects with any previous continuing disclosure obligations under the Rule.”

2012 Disclosure: “In the last five years of its annual reports, the District did not timely file…In addition, the District did not timely file a notice of rating event…The District has recently made the necessary filings to comply with the Rule and the District’s prior continuing disclosure undertakings and is now current…”

Memorandum #2015-01(July 3, 2014)
Secondary Market Reporting

"We request that local governments that are required to file continuing disclosure documents through EMMA submit proof of compliance to our office. There are limits, however, to SLGFD's monitoring and obtaining assurance that each unit has appropriately complied with their reporting requirements. In recent months we have observed that several units have failed to file accurate or complete continuing disclosure information…

"Though it is the responsibility of the local governmental unit to ensure compliance, failure to comply should be noted in the audit report on which the auditor is opining. In an attempt to facilitate compliance, the SLGFD will provide tools for auditors and local governmental units to use. Among the tools the SLGFD will make available will be post year-end procedures checklists for auditors and units, a list of affected units, and tutorials that will address the importance of compliance, the SLGFD submission requirements, and provide a brief introduction to the Initiative. We expect that these resources will be available and accessible online in August of 2014."

GFOA Alert (July 7, 2014)
The SEC MCDC Initiative and Issuers

While SEC is encouraging issuers and underwriters to participate by offering predetermined and more lenient settlement terms, the GFOA is urging members to exercise caution and familiarize themselves with the details of the initiative before consenting to engage in this program. For example, though the terms of the initiative preclude SEC from imposing monetary fines on participating issuers, the SEC reserves the right to pursue separate enforcements against individuals within a government who it deems to be culpable of the misstatements.

While the Rule only applies to underwriters and SEC is prohibited from directly regulating issuers under the 1975 Tower Amendment to the Securities Exchange Act of 1934 (Exchange Act), SEC has demonstrated through recent enforcement actions that making false statements in official statements about compliance with continuing disclosure obligations will be construed as securities law violations under Section 17(a) of the Securities Act of 1933 and/or Section 10(b) of the Exchange Act. Due to the typical five-year statute of limitations for securities law violations, the MCDC Initiative covers bond transactions dating back to September 2009. However, since final official statements must disclose compliance failures for the five years prior, the scope of the initiative actually looks back to 2004.

GFOA Alert (July 7, 2014) cont)

In response to the MCDC Initiative the underwriter community is actively conducting internal compliance investigations by reviewing the official statements for all bonds underwritten over the last five years and associated continuing disclosure filing data, to confirm whether the official statements for this period accurately described the issuer's prior compliance with continuing disclosure undertakings. The MCDC Initiative incentivizes underwriters to participate by placing a cap of $500,000 on all instances of material misstatements contained in an underwriters MCDC report. As a result many underwriters have indicated their intent to participate in the initiative, and are now compiling a list of bond issues that contain a misstatement regarding continuing disclosure compliance so that they can limit their financial and legal exposure to potential SEC enforcement actions. The lists being compiled by underwriters will identify issuers that the underwriters believe have not made all of their continuing disclosure filings required by the CDA, but indicated they have done so in official statements.

In most cases these lists will be compiled using continuing disclosure filings since 2009 made through the MSRB's Electronic Municipal Market Access (EMMA) platform. However, some underwriters are attempting to verify filings prior to 2009 when the dysfunctional Nationally Recognized Municipal Securities Information Repository (NRMSIR) system was in use. This is likely to lead to many erroneous findings of failures to file because of the known deficiencies of the NRMSIR system and difficulties in locating filings. Although underwriters are being encouraged to contact issuers with the results of their review to discuss any potential misstatements, they are not required to do so and may not have time to contact all issuers because of the unreasonably short deadline for the MCDC Initiative (September 10, 2014). These factors could result in underwriters participating in the initiative and falsely reporting that statements made by issuers pertaining to their prior continuing disclosure compliance are material misstatements when in fact they are not. For these reasons issuers should consider contacting all underwriters who have been senior or co-managers on their bond deals over the past five years and asking these underwriters for at least a month of notice in advance of September 10 of any planned participation in the MCDC initiative related to these bonds.

GFOA Alert (July 7, 2014) cont)

Further, if issuer is unsure of prior compliance or has reason to believe that it has failed to file information required by its CDA and inaccurately described this failure in its official statement over the last five years, they should consult with their legal counsel to ensure prior compliance. Issuers can evaluate the MCDC Initiative in light of their own circumstances and review their compliance with the CDA by using the guidance outlined below.

Guidance on Self-Examination in Response to MCDC Initiative:

1. **An issuer should disregard the MCDC Initiative entirely if:**

   - Has not issued bonds within the last five years.
   - Has issued bonds in the last five years but has:

     1. personal knowledge and supporting documentation that continuing disclosure filings required by the CDA have been made;
     2. policies and procedures in place to ensure compliance; or
     3. an outside vendor or counsel under contract engaged to assist with continuing disclosure filings that can confirm continuing disclosure compliance for the five-year period in question.

GFOA Alert (July 7, 2014) cont)

2. **If an issuer has publicly offered bonds since September 10, 2009 and is unsure whether it has complied with continuing disclosure undertakings, it should:**

- Review the description of past compliance in any official statements for bonds issued during the past five years. (The section is typically titled "Continuing Disclosure" in the official statement).

- If the description in the official statement says the issuer is in compliance with its continuing disclosure requirements, consider the best way to verify the statement including:

  - review of internal files that document continuing disclosure filings made on EMMA;
  - if internal files not maintained, review EMMA to verify continuing disclosure filings made;
  - contact the senior managing underwriter for the bond issue to determine if they have files documenting compliance with the CDA or are conducting a review of their prior bond deals to identify possible non-compliance; or
  - contact appropriate transaction participants that would be most knowledgeable about this matter, e.g., underwriters counsel, disclosure counsel, financial advisor or bond counsel.

- If the information in the official statement describes any instances of prior non-compliance (including instances that may be immaterial), the issuer can probably conclude that it has not misstated compliance and no further investigation is necessary.

GFOA Alert (July 7, 2014) cont)

3. **If an issuer discovers through a self-examination or through a discussion with counsel or an underwriter that the final official statement potentially contains inaccurate statements relative to past compliance with continuing disclosure obligations, the issuer should:**

   - Contact the bond or disclosure counsel to assess the materiality of the misstatement and assess/discuss the advantages/disadvantages of self-reporting under the MCDC Initiative if the misstatement is determined to be material.
   - Correct any prior non-compliance, if possible.
   - Adopt or enhance policies and procedures to ensure compliance with continuing disclosure obligations going forward and add a process for the thorough review of all issuer statements in the final official statement regarding compliance with the CDA.
   - Adopt policies and procedures that require all filings on EMMA to be documented and maintained.

GFOA Alert (July 7, 2014) cont)

Take the MCDC Initiative Seriously but Exercise Caution

The legal consequences of participating in the MCDC Initiative are significant and should be thoroughly evaluated with the assistance of counsel. Issuers should also consider the following information if contacted by an underwriter or asked to participate in the MCDC Initiative:

- Consult with legal counsel and exercise caution when determining if self-reporting under the MCDC Initiative is beneficial.
- Participating in the MCDC Initiative will need to be approved by the governing board of the issuer because of its legal significance.
- Self-reporting under the MCDC Initiative does not limit the personal liability of municipal officials and may expose an issuer or official to further SEC investigation and enforcement.

GFOA Alert (July 7, 2014) cont)

Take the MCDC Initiative Seriously but Exercise Caution cont)

- Self-reporting under the MCDC Initiative requires an issuer to sign and submit a questionnaire. By signing the questionnaire, the issuer:
  - Agrees to cooperate with the SEC and testify in the event of an SEC investigation; and
  - Consents in advance to all settlement terms (which will likely require approval of the governing body of the issuer prior to submission).
- Financial penalties for underwriting firms participating in the MCDC are capped at $500,000. As a result, underwriters have an incentive to over-report transactions without regard to materiality of any misstatements.
- If contacted by an underwriter, request the underwriter's list of findings so that the issuer can either verify that they are accurate or show that they are erroneous. Additionally, the facts can be evaluated to determine whether any inaccuracies are considered "material".

GFOA Alert (July 7, 2014) cont)

GFOA Advocacy on the Initiative

In an effort to streamline the requirements of the MCDC Initiative, make any review of CDA compliance process more manageable, and avoid unnecessary costs to issuers and underwriters, GFOA and several other industry groups including the National Association of Bond Lawyers (NABL) and Securities Industry and Financial Markets Association (SIFMA) met with the SEC Enforcement Division staff on June 18, 2014 and requested, among other things, the following:

- An extension of the deadline for participation in the MCDC Initiative to ensure that issuers and underwriters have sufficient time to work together to self-report true instances of non compliance and allow time for issuers to meaningfully evaluate the merits of participating in the MCDC Initiative.
- A narrowing of the scope of the review to only consider annual filings made to the MSRB's EMMA platform after July 1, 2009.
- A clarification from SEC as to what will not be considered material under the initiative.

The initial feedback from the SEC indicated an unwillingness to streamline the MCDC Initiative to improve the efficiency and effectiveness and reduce the uncertainties and burdens being imposed on issuers. GFOA will continue to press for common-sense changes to modify the MCDC Initiative and focus on constructive ways to improve continuing disclosure compliance.