

To Report or Not – The SEC’s New MCDC Initiative

**A Webinar Presented by Ballard Spahr’s
Municipal Securities Regulation and Enforcement Group and
AVANT Strategic Partners**

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MCDC Initiative – What Is It?

On March 10, 2014, the SEC's Enforcement Division introduced an initiative to encourage self-reporting:

- By municipal securities issuers, obligated persons, and underwriters of possible securities law violations
- Related to misrepresentations in offering documents concerning an issuer's prior compliance with its continuing disclosure obligations

The Municipalities Continuing Disclosure Cooperation Initiative (MCDC Initiative) is the latest SEC effort in a long campaign to require timely, accurate, and uniform secondary market information from municipal securities issuers

- Past efforts include indirect regulation through municipal securities underwriters, press campaigns, seeking additional regulatory authority from Congress, increased market transparency, and enforcement actions

MCDC Initiative – What Is It?

Before 2013, despite reports of widespread issuer noncompliance with at least some continuing disclosure obligations, the SEC had not brought a related enforcement action against an issuer or emphasized SEC Rule 15c2-12 in its enforcement actions against underwriters

MCDC Initiative – What Is It?

In July 2013, the SEC set a groundbreaking precedent by undertaking enforcement actions against Indiana's West Clark Community Schools and the school district's underwriter based on statements in offering documents that the school district was compliant with its previous continuing disclosure agreement.

- The school district hadn't submitted any of the required annual financials or event notices
- The SEC alleged that the underwriter's due diligence efforts were inadequate as it failed to discover that the school district was not compliant with its prior continuing disclosure obligations.

MCDC Initiative – What Is It?

Under the Municipalities Continuing Disclosure Cooperation Initiative (MCDC Initiative), the Enforcement Division will recommend “favorable settlement terms” upon self-reporting of such possible violations

For eligible self-reporters, the Enforcement Division will recommend:

- Settlement through cease-and-desist proceedings that do not require an admission of liability
- Not levying a financial penalty against issuers
- Tiered financial penalties against underwriters
 - Penalties will range from \$20,000 to \$500,000, depending on the size and number of offerings reported.

MCDC Initiative – What Is It?

Issuers' recommended remedial actions:

- Establishing compliance policies and procedures
- Complying with prior and existing continuing disclosure obligations
- Cooperating with subsequent SEC investigations
- Disclosing the terms of the settlement in its official statement for five years
- Providing a compliance certificate to the SEC regarding the above actions one year from the date on which the cease-and-desist proceeding is instituted

MCDC Initiative – What Is It?

Underwriters' recommended remedial actions:

- Retaining an independent consultant to undertake a compliance review and provide recommendations regarding the underwriter's due diligence process and procedures
- Implementing the consultant's recommendations
- Cooperating with subsequent SEC investigations
- Providing a compliance certificate to the SEC regarding the above actions one year from the date on which the cease-and-desist proceeding is instituted

MCDC Initiative – What Is It?



U.S. SECURITIES AND EXCHANGE COMMISSION DIVISION OF ENFORCEMENT

MUNICIPALITIES CONTINUING DISCLOSURE COOPERATION INITIATIVE QUESTIONNAIRE FOR SELF-REPORTING ENTITIES

Contact Info.

NOTE: The information being requested in this Questionnaire is subject to the Commission's routine uses. A list of those uses is contained in [SEC Form 1662](#), which also contains other important information.

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):

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:

Issue Info.

MCDC Initiative – What Is It?

Transaction
Participants

Role

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

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: _____

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):

Facts

MCDC Initiative – What Is It?

Certification

On behalf of [Name of Self-Reporting Entity] _____,
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 Initiative – What Is It?

Individuals **may not** self-report through the MCDC Initiative

The SEC's Enforcement Division will determine whether municipal officials and underwriting firm employees should be the subject of an SEC enforcement action on a **case-by-case** basis, considering such factors as the individual's level of intent and cooperation with the SEC

The Enforcement Division indicates that the remedies it seeks will be more severe for eligible issuers and underwriters who fail to self-report through the MCDC Initiative

The Division states that it will likely recommend financial penalties for such non-reporting issuers and financial penalties higher than those set forth in the MCDC Initiative for such non-reporting underwriters

MCDC Initiative – What Is It?

**The clock for this voluntary self-reporting ends at
midnight EDT on September 10, 2014**

MCDC Initiative – A Glance at Historical Compliance

A study released in 2011 by *DPC Data Inc.* (a former NRMSIR) found that for fiscal years 2005-2009:

- “For any of the five years, at least a third of the expected disclosures were never filed in the designated official repositories. In 2008 and 2009, the nondisclosure behavior rose to 36 percent and 40 percent, respectively.
- For the period of study, 56 percent of issuers/obligors did not file annual disclosures for one or more years; 19 percent did not file for any of those years.”

A similar study by the California Debt and Investment Advisory Commission (CDIAC) focused on 2010 annual disclosure filings for bonds in its database that were issued between 2005-09. The study found that only 72% of issues sampled met their obligation to file their 2010 CAFR with EMMA on time. Almost 10% failed to file at all.

MCDC Initiative – A Basic Approach to Evaluating Exposure

1. Compile a listing of bonds issued within the last five years—this is the ‘universe’ that must be tested for false or misleading statements vis a vis prior disclosure undertakings
 - What did the offering documents say (or not say) about prior disclosure compliance?
 - Were any statements materially misleading (e.g., West Clark Community Schools statement below)?

Compliance with Previous Undertakings

In the previous five years, the School Corporation has never failed to comply, in all material respects, with any previous undertakings in a written contract or agreement that it entered into pursuant to subsection (b)(5) of the Rule.

Note: If no bonds were issued within the last five years, MCDC is not relevant. However, now is a good time to review or establish formal policies and procedures related to ongoing disclosure obligations and remedy any prior lapses in compliance.

MCDC Initiative – A Basic Approach to Evaluating Exposure

2. Research prior compliance for all relevant issues of the Obligated Person. The scope of the review should include all issues outstanding during the five years leading up to the date of the offering document(s). Depending on circumstances, the review may need to go back as far as ten years.
 - Prior to July 1, 2009, filings were posted with the NRMSIRs
 - Bloomberg L.P.
 - DPC Data
 - Interactive Data Pricing and Reference Data
 - Standard & Poor's
 - On or after July 1, 2009, all filings posted to EMMA
 - Is it safe to assume that use of a dissemination agent means everything is okay? Not necessarily...
 - Most DA's simply post, but do not actually review content for completeness.
 - Posting errors happen

MCDC Initiative – A Basic Approach to Evaluating Exposure

3. For each relevant bond issue, compare the requirements stated in the Continuing Disclosure Agreement (CDA) to what was actually posted to the NRMSIRs and EMMA
 - There may be different requirements for different types of issues. For example, requirements for revenue bonds often include specific information that is not included in annual financials, whereas the requirement for GO bonds may be as simple as posting the CAFR each year.
 - Were all required filings made? Were they made on time? Did the content of each filing meet the requirements listed in the CDAs?
 - Material Event disclosures are difficult to evaluate:
 - If a tree falls in the woods...
 - What is timely? For bonds issued after December 1, 2010, timely is defined as within 10 business days of the event. However, for bonds issued prior to that date the requirement was more ambiguously defined as “in a timely manner”.
 - Pay particularly close attention to ratings changes and other events that are easily verifiable through data mining.

MCDC Initiative – A Basic Approach to Evaluating Exposure

4. Review findings with legal counsel familiar with SEC rules and enforcement
 - Are discovered lapses material?
 - Does self-reporting create exposure elsewhere?
5. Coordinate with underwriters to ensure findings are consistent with each other
 - Underwriters may be incented to report more vs. less.
 - Compare notes early so there's time to resolve inconsistencies and/or differences of opinion regarding materiality.

THE TOWER AMENDMENT

Section 15B(d)(1) of the Exchange Act

Neither the Commission nor the Board is authorized under this title, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the Commission or the Board prior to the sale of such securities by the issuer any application, report, or document in connection with the issuance, sale, or distribution of such securities.

MCDC Initiative – Statutory Authority

- Section 10(b) of the Securities Exchange Act of 1934
 - Rule 10b-5: Employment of Manipulative and Deceptive Practices
- Section 17(a) of the Securities Act of 1933

MCDC Initiative – Penalties

Penalties: Administrative Proceedings

- Cease-and-desist order
- Monetary Fines

Penalties: Civil Actions

- Injunctions
- Monetary Fines

Demanding Admissions: Post-Financial Crisis Overhaul of SEC Enforcement

“We are going to in certain cases be seeking admissions Public accountability can be quite important, and if you don't get them, you litigate them. What kinds of cases are those? To some degree it turns on how much harm has been done to investors, how egregious the fraud is.”

*-SEC Chair Mary Jo White
June 23, 2013*

MCDC Initiative – Pursuing Individuals

“Individuals tempted to commit wrongdoing must understand that they risk it all if they do not play by the rules. When people fear for their own reputations, careers or pocketbooks, they tend to stay in line.”

*-SEC Chair Mary Jo White
September 26, 2013*

MCDC Initiative – History

How has the SEC gone about the enforcement business in the past?

- Seminal enforcement Action in 1996 was Orange County, CA
Takeaway: Governing body is responsible for the review and approval of the offering document
- Additional enforcement actions including Maricopa County, Arizona; Allegheny Health, Educational and Research Foundation; City of Miami (Version 1); and Massachusetts Turnpike Authority.

MCDC Initiative – History

City of San Diego, November 14, 2006:

- \$260 million in bond offerings in 2002 and 2003
- City was facing a looming financial crisis, resulting from
 - intentional underfunding of its pension plan for 5 years
 - retroactive increases in pension benefits
 - use of surplus earnings to pay additional benefits to plan beneficiaries
- City failed to disclose these problems in its bond offerings
- In 2008, the SEC charged five former San Diego officials with securities fraud based upon the inadequate disclosures

MCDC Initiative – History

City of Harrisburg, May 2013

- First SEC action against a municipality based upon statements made publicly as opposed to in the securities disclosure documents
- City was charged with misleading investors about its financial health in the annual State of the City address, as well as in financial and budget reports
- During a time in which the City failed to comply with its continuing disclosure obligations
 - “Total mix” of information analysis
 - As no information on EMMA, investors looked to other sources

MCDC Initiative – History

- No public officials were named in the action, but, according to the SEC’s press release announcing the action, the case should “emphasize to public officials who wish to avoid personal liability under federal securities laws that they should take steps to reduce the risk of misleading investors.”
- Commissioner Daniel Gallagher recently cited to Harrisburg as an action in which individuals should have been held responsible, stating to The Bond Buyer that “[m]unicipalities don’t commit frauds, people do”

MCDC Initiative – History

West Clark Community Schools, July 2013

- First action charging a municipal issuer with falsely claiming in a bond offering's official statement that it was fully compliant with continuing disclosure obligations and an underwriter for not doing the necessary due diligence
- In an official statement prepared in 2007 for a bond offering on behalf, the school district stated that it was in compliance with its disclosure obligations related to prior bond offerings
- However, West Clark had not submitted any of the required annual reports or notices for a 2005 bond offering
- Underwriter, did not conduct adequate due diligence to detect the false statement in the course of the 2007 offering

MCDC Initiative – History

In the Matter of the Greater Wenatchee Regional Events Center Public Facilities District, November 2013

- Issuer charged with negligently misleading investors in a bond offering that financed the construction of a regional events center and ice hockey arena
- According to SEC, Official Statement:
 - Failed to warn investors that the District's obligation to pay off the BANs could be constrained by the City's debt limit
 - Wrongly stated there had been no independent reviews of the financial projections for the events center
 - Failed to inform investors that the Mayor and the senior staffer had influenced the financial projections, rendering them unduly optimistic

MCDC Initiative – What it Does Not Cover

Covers Only CDA Noncompliance

- Other Misrepresentations Not Covered
- Individuals Not Covered
- Officials of Issuers, and Underwriter Employees and Supervisors Not Covered
- Individuals Must Be Identified

Referrals to Other Agencies (FINRA, DOJ, state regulators) May Occur

MCDC Initiative – The Collateral Consequences of Self-Reporting

Self-reports May Be Viewed As Admissions

- May Not Be Withdrawn if Settlement Negotiations Are Not Favorable
- May Serve as the Basis for Bondholders Suits
- May Serve as the Basis for Other Regulatory Action

Invites Scrutiny of Other Disclosures

- May Result from Enforcement Actions against Individual Officials, Underwriter Employees

Conflicts

MCDC Initiative – Whether To Self-Report: Materiality

The Well-Established Standards:

- To violate Rule 10b–5, a statement or omission must be “misleading as to a material fact.”
- For the purposes of Rule 10b-5, a fact is material “if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.”
- Omitted information is considered material if there is 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.”

MCDC Initiative – Next Steps

- Whether you are going to report or not, first conduct an internal audit
- If you do find a misrepresentation, consult with counsel to determine materiality
- If there is a potential material misrepresentation, analyze possible consequences of self-reporting
- If applicable, submit a questionnaire and have your counsel enter into discussions with the SEC to follow up

Thank You!

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