



ACCESS TO CAPITAL

The SEC's Municipalities Continuing Disclosure Cooperation Initiative – An Inevitable Dilemma?

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Presenters

		
<p>Dave Bannard Partner Foley & Lardner LLP (Boston) dbannard@foley.com</p>	<p>Heidi Jeffery Partner Foley & Lardner LLP (Chicago) hjeffery@foley.com</p>	<p>Phillip Goldberg Partner Foley & Lardner LLP (Chicago) pgoldberg@foley.com</p>

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Overview

- Introduction of Panelists and Purpose of Webinar
- Background Regarding Municipalities Continuing Disclosure Cooperative Initiative
 - Applicability
 - Questionnaire
 - Timing
- Practical Considerations/Q&A

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Background Regarding Municipalities Continuing Disclosure Cooperative Initiative



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Background Regarding MCDC

1. **Background**
 - Continuation of recent scrutiny
 - Recent SEC guidance and enforcement actions
2. **Specifics**
 - Applicability
 - Timing
 - Questionnaire
3. **Additional Considerations**
 - Formal SEC settlement
 - Authorization
 - No individual protection from liability
 - Settlement Terms

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Continuing Disclosure Obligations

- Tower Amendment prohibits direct federal regulation of municipal issuers
- SEC Rule 15c2-12 requires underwriters to ascertain that issuers and obligated persons have entered into a continuing disclosure undertaking (CDU) that meets certain requirements
- CDU must require provision of annual data and disclosure of certain material events
- Official Statements must disclose failure to comply with CDU obligations

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Continuation of Recent Scrutiny

- MCDC Initiative can be seen as direct outgrowth of *West Clark* case.
 - Both issuer and underwriter cited for failing to disclose issuer's failure to comply with CDU
- SEC has long expressed concern regarding continuing disclosure failures. Recent actions include:
 - 2010 changes to "tighten" Rule 15c2-12
 - 2012 SEC report that identified continuing disclosure as an ongoing concern
 - Market participants, e.g., NMFA, reporting continuing failures to provide annual and event disclosure

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Recent SEC Enforcement Actions

- Increased SEC emphasis on issuer controls and procedures – in majority of recent actions, SEC has required issuers to undertake certain practices and procedures
- Increased SEC willingness to pursue anti-fraud charges against negligent (not just intentional) disclosure failures (City of South Miami)

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Recent SEC Enforcement Firsts

- In the past year, the SEC has had several “firsts”:
 - First SEC charge of issuer for materially misleading statements outside of a disclosure document (City of Harrisburg)
 - First SEC monetary penalty assessed against an issuer (Greater Wenatchee Public Facilities District)
 - First SEC charge of issuer violation of a prior cease and desist order (City of Miami)
 - First SEC charge of issuer for falsely stating that it complied with continuing disclosure requirements (West Clark Schools)

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Specifics--Applicability

- MCDC Initiative applies *ONLY* to material misstatements regarding compliance with CDUs
 - does not apply to any other disclosure issues.
- Creates “modified prisoner’s dilemma” between issuers and underwriters.
- Limited window to take advantage of Initiative – ends September 10. Thereafter, penalties likely to be more severe.
- Provides standard settlement terms to participants.

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Specifics--Applicability

- The Initiative covers both negotiated and competitive underwritings.
- Only entities (issuers and underwriters) can use the Initiative
 - SEC retains right to seek enforcement against culpable individuals.
- Files will be processed in order of self-reporting.
- Anticipated to be a 2-3 month process from start to finish.

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Self-Reporting Process: The Questionnaire

- Participants self-report by completing and filing a questionnaire, which includes:
 - Name and contact information for lead underwriter, municipal advisor, bond counsel, underwriter's counsel and disclosure counsel
 - Any facts relating to the potentially inaccurate statements the participant deems relevant – this may allow reporting of “gray” issues that are not necessarily material
 - A statement by the participant that it intends to consent to the standard settlement terms under the Initiative

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Additional Considerations-Global Settlement Terms

- For issuers and underwriters the Enforcement Division will recommend settlement terms to the SEC that include:
 - Consent to a cease and desist proceeding with no admission or denial of the SEC's findings.
 - Cooperating with any subsequent SEC investigation regarding the reported false statements, including the roles of individuals and other parties.
 - Providing the SEC with a certification of compliance with the requirements of the cease and desist order on its first anniversary.
 - However, settlements are still an SEC enforcement action and deserve careful consideration.

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Additional Considerations--Settlement Terms for Issuers

- Must establish continuing disclosure compliance policies and complete training of personnel within 180 days.
- Comply with all existing undertakings and remedy all past delinquent filings within 180 days.
- Disclose the settlement terms "in a clear and conspicuous fashion" in each official statement for the next five years.
- The Enforcement Division will not recommend imposing a monetary penalty on issuers and obligated persons; penalty limited to maximum of \$500,000 for underwriters.

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Settlement Terms - Authorization

- This is a formal SEC settlement
- Review corporate authorization
- No individual protection from liability

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Questions: What does the Initiative Cover?

- What does the Initiative cover?
- The Initiative covers inaccurate statements in official statements regarding continuing disclosure compliance, not compliance with the undertakings themselves.
- The first steps to determine whether to participate:
 - Review past official statements for descriptions of compliance with previous continuing disclosure undertakings for the last five years, and
 - Review continuing disclosure filings during that period and determine whether the official statement descriptions were accurate.

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Questions: What are an issuer's first steps?

- How should an issuer determine whether to participate?
- The first steps to determine whether to participate:
 - Review past official statements for descriptions of compliance with previous continuing disclosure undertakings for the last five years, and
 - Review continuing disclosure filings during that period and determine whether the official statement descriptions were accurate.

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Questions: Determining whether to participate

- Under Rule 15c2-12, Official Statements are required describe instances of failures to comply in all material respects with prior continuing disclosure undertakings.
- Many Official Statements include an affirmative statement that the issuer has never failed to comply with a prior undertaking.
- Some Official Statements say nothing about continuing disclosure compliance – can be construed as implicit statement of compliance.

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Questions: Please Clarify five year/ten year references?

- The period covered by the Initiative is determined by the statute of limitations for civil penalty actions by the SEC, which is five years from when the misleading disclosure occurred.
 - Official Statements dating back to 2009 should be reviewed.
 - Since Official Statements are required to disclose non-compliance with undertakings during the five preceding years (the “look-back”), disclosure filings back to 2004 may need to be reviewed.

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Questions: Should an Issuer Self-Report?

- Fact specific
- An issuer that **did not** have a material failure to comply with undertakings during the look-back period, had no obligation to disclose anything in an Official Statement under either Rule 15c2-12 or the anti-fraud provisions.
- An issuer that **did** have material failure(s) to comply with undertakings during the look-back period **and** accurately disclosed the failure(s) in each Official Statement, met the requirements of both Rule 15c2-12 and the anti-fraud provisions.

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Questions: After Review, Should an Issuer Self Report?

- An issuer that falsely stated in an Official Statement that it was in (material) compliance with its previous continuing disclosure undertaking.
- An issuer that failed to disclose in an Official Statement its material failure(s) to comply with previous continuing disclosure undertakings.
- If an issue is identified, consider consulting with counsel to determine whether misstatement or omission was material.

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Questions: What if Underwriter Reports?

- Chief of SEC's Municipal Securities Enforcement Unit has stated that the Initiative is intended to create a "modified prisoner's dilemma".
 - If one party self-reports, the other party has a bigger problem if it fails to self-report.
 - This tension between issuers and underwriters is a deliberate effort by the SEC to promote self-reporting by all issuers and underwriters.

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Questions: What is material?

- Two different materiality considerations are at play:
 - Was there “material” noncompliance with an undertaking that required disclosure? (financial statements one day late)
 - Was a false statement (or omission) regarding undertaking compliance information that a reasonable investor would consider material?
- By the prisoner’s dilemma, the SEC is promoting over-reporting of disclosure failures, even those that may not be material.

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Questions: Any final take aways?

- We understand some underwriters have been notifying issuers.
- SEC will recommend enforcement proceedings (cease and desist order) only for disclosure failures it considers material.
- The SEC is emphasizing that the standard settlement terms are favorable in comparison to penalties it will impose on those who fail to self-report.
- Time is ticking.
- Possibility of enforcement actions against individuals considered responsible for disclosure failures.

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Q&A Session

If you have a question, please submit it through the Q&A window on your screen.