

One Minute Memo®



SEC's Municipal Bond Cooperation Initiative Set to Expire for Underwriters (on Sept. 10) and Issuers (on Dec. 1)

Favorable Settlement Terms Available for Self-Reporters for a Limited Time

By Philip M. Smith and Christopher F. Robertson

In March 2014, the SEC announced an initiative intended to address potentially widespread securities laws violations by municipal bond issuers and underwriters arising from any failure to provide continuing disclosure of matters that render previous disclosures materially inaccurate. Under the Municipalities Continuing Disclosure Cooperation (MCDC) initiative, the SEC warned that it may file anti-fraud enforcement proceedings against the municipalities and their bond underwriters if they have either failed to provide continuing disclosure or falsely represent that they have complied with their continuing disclosure obligations when they have not in fact done so. Pursuant to the MCDC initiative, however, the SEC has offered a modified amnesty of sorts to municipalities and their bond underwriter who voluntarily disclose their failures to provide continuing disclosure. To date, the SEC has revealed only one settlement with a municipal unit — a California school district — under the MCDC initiative, which may suggest that a multitude of municipal issuers and underwriters whom the SEC saw as scofflaws either haven't gotten the message. Of course, it also means that many issuers and underwriters have been busy for months determining what omitted disclosures over the prior 10 years are material or immaterial, and how to handle a potentially complex array of considerations before and after self-reporting violations. On July 31, 2014, the SEC announced that it was extending the deadline for self-reporting under the MCDC from September 10 to December 1, 2014, for issuers but not for underwriters.

Rule 15c2-12 of the Securities Exchange Act of 1934 requires underwriters to ensure that municipal bond issuers enter into an agreement to provide information about the financial health of the issuer to the Municipal Securities Rulemaking Board (MSRB) about the bonds on an ongoing basis. The issuers' agreement, a Continuing Disclosure Agreement, requires that issuer to file annual financial information reports and notices of certain material events with the Electronic Municipal Market Access (EMMA), an electronic information repository system maintained by the MSRB, which is then accessible to all investors. Before July 2009, such information was disclosed through other information repositories. Rule 15c2-12 also generally requires that any final official statement prepared in connection with a primary offering of municipal securities contain a description of any instances in the previous five years in which the issuer failed to comply, in all material respects, with any previous commitment to provide such continuing disclosure. The SEC's focus then is on both failure to provide ongoing disclosure and failure to disclose prior failures.

Under the MCDC initiative, the division of enforcement will recommend that the Commission accept a settlement with an issuer which self-reports that includes (1) a cease and desist order covering a violation of Section 17(a)(2) (covering negligent misstatements); (2) a provision that the issuer neither admits nor denies the SEC allegations; (3) an undertaking by the issuer to remedy past disclosure violations; (4) an undertaking by the issuer to establish a training and compliance program; and (5) no civil money penalty. For underwriters, in addition to the foregoing terms the SEC will require the retention of an independent consultant to review and recommend compliance improvements and will impose capped penalties.

The MCDC initiative is an opportunity to avoid large penalties and a fraud-based injunction or worse. It is also a warning of potentially harsh enforcement actions against issuers and underwriters who fail to take advantage of the initiative. The MCDC initiative does not, however, guarantee a particular enforcement decision for self-reporters and it specifically does not cover individuals, so consideration of any self-reporting should begin immediately but with extreme caution. Perhaps most importantly, neither Rule 15c2-12 nor the MCDC initiative mandates retroactive disclosure of immaterial events and changes, so the first step is to immediately perform a thorough compliance analysis for municipal bond offerings for the last ten years to determine whether there is a disclosure issue at all.

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