Municipalities Continuing Disclosure Cooperation Initiative to Sunset on Dec. 1, 2014

By Gary T. Pope, Jr. and Matthew J. Davis

In recent years, the U.S. Securities and Exchange Commission (SEC) has increasingly focused on disclosure in the municipal bond market, with a particular focus on continuing disclosure. SEC interpretive releases have also made clear that the official statement is the issuer's document and that the issuer is primarily responsible for its content and accuracy.

This responsibility includes the requirement, for a document to qualify as an official statement, to describe any instances in the five years prior to the date of the official statement where the issuer "failed to comply in all material respects, with any previous" continuing disclosure agreement. *See Rule 15c2-12 promulgated under the Securities Exchange Act of 1934.*

A flurry of recent SEC enforcement actions related to disclosure and findings of noncompliance has culminated, at this point, with the Municipalities Continuing Disclosure Cooperation (MCDC) initiative, which was announced by the SEC on March 10, 2014. The SEC describes the MCDC program as an opportunity for issuers and underwriters of municipal bonds to self-report material misrepresentations concerning continuing disclosure in official statements in exchange for favorable settlement terms. The deadline for underwriters to self-report was Sept. 10, 2014, and the deadline for counties (and other issuers) to self-report is Dec. 1, 2014.

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For counties, the MCDC program is only applicable if the county:

(i) issued bonds in the past five years,

(ii) distributed an official statement in connection with that bond issuance, and

(iii) made a misstatement in that official statement regarding its compliance with any pre-existing continuing disclosure obligation. A pre-existing continuing disclosure obligation would have arisen from a prior bond transaction in which an official statement was prepared in connection with the sale of the bonds, and an agreement to provide continuing disclosure in the form of audits and other operating data was agreed to.

The first step in determining whether the MCDC program is relevant to a county is to determine whether it is applicable. Failures to live up to continuing disclosure obligations are not the object of the MCDC program; rather the program is aimed at material misstatements about past compliance. If a county hasn't issued bonds using an official statement in the past five years, then the MCDC program is not applicable to that county. If a county issued bonds using an official statement within the past five years, but didn't have any existing continuing disclosure obligations in connection with a prior transaction at the time those bonds were issued, then the MCDC program is not applicable to that county. If, however, a county issued bonds in the past five years using an official statement and made a statement concerning compliance with existing continuing disclosure obligations, then we encourage a full review.

If a county previously issued bonds, and an official statement was prepared in connection with that issuance of bonds, it is possible that the underwriter of those bonds has reached out to the county in writing to inform that county whether the underwriter would be self-reporting to the SEC in connection with that issuance of bonds. Counties should check their files to see if any similar correspondence has been received from underwriters. If no correspondence has been received, and a county is eligible for the program, we encourage reaching out to the underwriter of the eligible issue to discover whether the underwriter made an MCDC report.

If an underwriter has reported a bond issue or if your review of any of your county's official statements reveals a misstatement regarding compliance with continuing disclosure obligations, or if it is unclear whether a misstatement was made, we strongly encourage you to contact bond counsel or disclosure counsel to assess your individual circumstances. In addition to determining whether a misstatement was made, counsel can help you determine whether a misstatement was "material" pursuant to federal securities laws. If a misstatement is found to be not material, then self-reporting may not be to a county's advantage.

If it is found that a material misstatement regarding compliance with continuing disclosure obligations has been made, possible settlement terms under the MCDC program include:

1) A cease and desist proceeding where the county neither admits nor denies the findings of the SEC,

2) Agreement to establish county policies and procedures to improve continuing disclosure compliance,

3) Cooperation with the SEC in subsequent investigations of the reported bond issue,

4) Disclosure of the settlement terms in future official statements for the next five years, and

5) Provision of a certificate to the SEC regarding compliance on the one year anniversary of the settlement. Counties have until Dec. 1, 2014 to determine whether to participate in the MCDC program.

The SEC has suggested that settlement terms will be less favorable if a county is found to have made a material misstatement with regard to continuing disclosure, but did not participate in the MCDC program by the Dec. 1, 2014 deadline. Specifically, the SEC has stated that it will pursue monetary penalties against issuers in an amount similar to that assessed against underwriters in the MCDC framework.

Those penalties include a civil penalty of $20,000 per offering of less than $30 million containing a materially false statement, and $60,000 per offering in excess of $30 million containing a materially false statement.

Other conduct-based settlement terms are likely to be more onerous than in the MCDC framework. Still, a county should not take self-reporting lightly and should thoroughly review its options.

It is extremely important that a county reach out to legal counsel regarding the MCDC program if that county has received notification from an underwriter that the underwriter reported the county to the SEC. Even if a county feels that it was mistakenly reported by an underwriter, the SEC may react more favorably to a proactive defense rather than silence from the county. A county may reach out to the SEC to explain the circumstances surrounding a reported event even if the county believes that it was incorrectly reported by an underwriter.

Participation in the MCDC program should not be considered mandatory or necessarily advisable, but a decision not to participate after finding any noncompliance should be fully vetted and the consequences understood. If a county has been reported by an underwriter, the county has already been drawn in to a regulatory-law enforcement process that must be taken seriously.

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