HAWKINS ADVISORY

MCDC SETTLEMENTS WITH ISSUERS

Introduction

Today, the Securities and Exchange Commission ("SEC") entered into cease-and-desist settlement orders with 71 municipal issuers and obligated persons, across 45 states, that had self-reported pursuant to the SEC's Division of Enforcement's Municipalities Continuing Disclosure Cooperation ("MCDC") Initiative.[1] The SEC had previously settled, in three separate announcements, with 72 underwriting firms, which the SEC has noted comprised approximately 96% of the market share for municipal underwritings. It is unclear from today's SEC press release whether there will be additional settlement orders with other municipal issuers and obligated persons.[2]

Misleading Disclosures

The MCDC Initiative was a self-reporting initiative available to issuers[3] and underwriters regarding materially inaccurate statements in Official Statements relating to prior compliance with Rule 15c2-12 Continuing Disclosure Agreements. The SEC does not have jurisdiction to directly enforce compliance with private contracts such as the Continuing Disclosure Agreements, but it does have jurisdiction to enforce misleading disclosures made in Official Statements regarding such compliance.

Based on a preliminary analysis of representative settlement orders, issuers had affirmatively stated that they were in compliance with their continuing disclosure obligations (some statements were limited to the preceding five years, others had no such time limit; some said they were in compliance in all material respects, others did not have such limitation), when in fact there had been failures to file audited financial statements and/or financial information and operating data. In some cases the filings were late by a few months, in other cases the filings were late by a few years. In most cases, there also had been a failure to file a notice advising that the annual financial information would be filed late.

Type of Proceeding

The settlement orders follow the terms set forth in the MCDC Initiative. Those terms provide:

- Cease-and-desist Order
- Violation is of Section 17(a)(2) of the Securities Act of 1933 (for which the standard is negligence)
- Issuer agrees to neither admit nor deny the findings of the SEC

Undertakings

The undertakings set forth in the settlement orders track the MCDC Initiative, and require the Issuer to undertake to:

- Establish appropriate policies and procedures and training regarding continuing disclosure obligations within 180 days of the date of the settlement order
- Comply with existing continuing disclosure undertakings, including updating past delinquent filings within 180 days of the settlement order
- Cooperate with any subsequent investigation by the SEC's Division of Enforcement regarding the misleading statements, including the roles of individuals or other parties involved
- Disclose in a clear and conspicuous fashion the settlement terms in any Official Statement for an offering by the Issuer within five years of the date of the settlement order
- Provide to the SEC staff a compliance certification regarding the applicable undertakings by the Issuer on the one year anniversary of the date of the settlement order

[1] The MCDC Initiative was the subject of a HAWKINS ADVISORY dated April 11, 2014, which described the terms of the Initiative and the applicable legal standards, and provided a brief analysis. http://www.hawkins.com/docs/news.165.pdf

See also the National Association of Bond Lawyers' "MCDC Initiative – Considerations for Analysis by Issuers of Materiality and Self-Reporting." (August 5, 2014) https://www.nabl.org/portals/0/documents/MCDC_Initiative_-_Considerations_for_Analysis_by_Issuers_of_Materiality_and_Self-Reporting_8-5-14.pdf

[2] It is interesting to note that the SEC press releases that accompanied the first two announcements of MCDC settlements with underwriters referred to the "MCDC Initiative, which is continuing . . . ." That reference to the Initiative continuing is not included in today's press release.

[3] The MCDC Initiative defined "issuers" to mean collectively "issuers and obligated persons involved in the offer or sale of municipal securities."

Distinctions from Underwriter Settlements

Underwriters were required to retain independent consultants; there is no such requirement for Issuers. Underwriters were required to address broadly their "municipal underwriting due diligence process and procedures," while the Issuer settlements only refer to procedures and training related to continuing disclosure obligations. The Underwriters were required to pay civil penalties, which varied based on the volume of underwriting conducted by a firm and the bond size of the offerings in question. The Issuers were not required to pay civil penalties.

Impact on Ratings

Standard & Poor's issued a report on August 15, 2016, entitled "What Will a Continuing-Disclosure Settlement Mean for Muni Credit?". The report advised that S&P will "consider the potential credit implications of each on a case-by-case basis," and noted that "we do not expect the settlements themselves to translate into rating downgrades if settling issuers respond with proactive approaches to addressing any identified deficiencies in their disclosure practices."

Written Disclosure Policies and Procedures

The National Association of Bond Lawyers ("NABL") prepared a paper regarding written disclosure policies for issuers, which was "intended to provide counsel with information to help issuer clients develop effective policies and procedures to facilitate compliance with their disclosure obligations under the federal securities laws."[4] That paper contained a link to the NABL website, at which are posted various examples of written disclosure policies (certain of which were prepared by Hawkins Delafield & Wood LLP).

The policies and procedures need to be carefully tailored to reflect the particular circumstances of each issuer. For example, the policies and procedures for large, frequent issuers with numerous staff persons responsible for disclosure will in many cases be inappropriate for small, infrequent issuers. In addition, the procedures that are required as part of the MCDC Initiative settlement orders with issuers are limited to continuing disclosure procedures. For this purpose, a continuing disclosure template that sets forth the disclosure filing requirements and the respective filing deadlines may be more appropriate. In addition to drafting and providing training related to comprehensive written disclosure policies and procedures, Hawkins has also assisted issuers in preparing these continuing disclosure templates.

For additional information regarding preparation of written disclosure policies and the conducting of associated training, please contact the following partners in our respective offices:

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[4] National Association of Bond Lawyers, "Crafting Disclosure Policies" (August 20, 2015). https://www.nabl.org/DesktopModules/Bring2mind/DMX/Download.aspx?PortalId=0&TabId=176&EntryId=1008

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