

# Client Alert

Current Issues Relevant to Our Clients

March 12, 2014

## SEC Announces Municipalities Continuing Disclosure Cooperation Initiative To Encourage Self-Reporting of Municipal Disclosure Violations

On March 10, the Division of Enforcement of the Securities and Exchange Commission announced its Municipalities Continuing Disclosure Cooperation Initiative (MCDC Initiative). The MCDC Initiative provides for self-reporting by issuers and obligated persons of materially inaccurate representations in offering documents (official statements) regarding their compliance with continuing disclosure undertakings under Rule 15c2-12. Lead and sole underwriters may also self-report their failure to confirm the truthfulness of these representations under the MCDC Initiative.

In the SEC's press release announcing the MCDC Initiative, the Director of the Enforcement Division, Andrew J. Ceresney, stated:

*The Enforcement Division is committed to using innovative methods to uncover securities law violations and improve transparency in the municipal markets. We encourage eligible parties to take advantage of the favorable terms we are offering under this initiative. Those who do not self-report and instead decide to take their chances can expect to face increased sanctions for violations.*

Under the MCDC Initiative, issuers, obligated persons and underwriters must report disclosure violations by September 10, 2014, and will be subject to standard settlement terms specified in the MCDC Initiative.

### Continuing Disclosure and Enforcement Overview

---

Rule 15c2-12 requires underwriters of municipal securities to determine that issuers and obligated persons have entered into a written undertaking to provide continuing disclosures of annual financial and operating information and notice of certain reportable events to the MSRB's EMMA system. Rule 15c2-12 also requires that official statements include descriptions of these undertakings, and of any failures by the issuer or obligated person to comply in all material respects with such undertakings during the previous five years.

While the registration and reporting requirements of federal securities law do not apply to municipal securities, the anti-fraud provisions of federal securities law do apply. In a recent enforcement action, the SEC charged a school district and its underwriter with anti-fraud violations for falsely stating in an official statement that the school district had complied fully with its continuing disclosure obligations during the preceding five years.  
[[http://www.chapman.com/media/publication/193\\_alert.pdf](http://www.chapman.com/media/publication/193_alert.pdf)]

### The MCDC Initiative

---

In its press release, the Enforcement Division reiterated its concern that issuers and obligated persons are frequently violating the anti-fraud provisions by making false disclosures in official statements regarding their continuing disclosure compliance, and that underwriters are failing to "exercise adequate due diligence" to determine the truthfulness of these disclosures. The goal of the MCDC Initiative is to encourage self-reporting by issuers, obligated persons and underwriters by offering more favorable settlement terms than if such violations are subsequently detected pursuant to an SEC investigation.

*MCDC Initiative Participation.* The Enforcement Division is encouraging participation in the MCDC Initiative by issuers and obligated persons that may have made materially inaccurate statements in an official statement regarding their prior compliance with their continuing disclosure undertakings. A lead underwriter or a sole underwriter in a municipal securities offering (whether negotiated or competitive) in which such statements were made may also participate in the MCDC Initiative. Issuers, obligated

persons and underwriters that have been contacted by the SEC prior to March 10, 2014, but have not yet been subjected to a formal enforcement action may be eligible for participation in the MCDC Initiative and are asked to contact the Enforcement Division to discuss their eligibility.

The MCDC Initiative is not available to individuals associated with or employed by issuers, obligated persons or underwriters, and enforcement actions against such individuals will be considered by the Enforcement Division on a case-by-case basis. Remedies sought against individuals pursuant to an enforcement action may exceed the terms of a settlement under the MCDC Initiative.

*Self-Reporting Process.* Issuers, obligated persons and underwriters participating in the MCDC Initiative must self-report by completing and submitting the MCDC Initiative questionnaire by September 10, 2014.

[<http://www.sec.gov/divisions/enforce/mcdc-initiative-questionnaire.pdf>] The information that must be reported in the questionnaire includes:

- Contact information for the issuer, obligated person or underwriter that is self-reporting;
- Information regarding the municipal securities offerings containing the potentially inaccurate statements regarding an issuer's compliance with the continuing disclosure requirements under Rule 15c2-12;
- Identification of the lead underwriter, municipal advisor, bond counsel, underwriter's counsel and disclosure counsel, to the extent applicable, and the primary contact person at each entity;
- Any facts that the self-reporting issuer, obligated person or underwriter would like to provide to assist SEC staff in understanding the circumstances that may have led to the potentially inaccurate statement or statements; and
- A statement that the self-reporting issuer, obligated person or underwriter intends to consent to the applicable settlement terms under the MCDC Initiative.

## Standardized Settlement Terms Under MCDC Initiative

If the Enforcement Division determines that the self-reporting issuer, obligated person or underwriter is eligible for participation in the MCDC Initiative and concludes that an enforcement action against the entity is warranted, the Enforcement Division will recommend a settlement to the SEC that includes the following general terms:

### Issuers and Obligated Persons

*Cease and Desist Proceeding.* The settlement will require an issuer or obligated person to consent to the institution of a cease and desist proceeding under which it will neither admit nor deny the findings of the SEC.

*Compliance Undertakings.* An issuer or obligated person participating in the MCDC Initiative will be required to implement the following undertakings to improve its continuing disclosure compliance:

- Establishing policies and procedures and appropriate training regarding continuing disclosure obligations within 180 days;
- Complying with existing continuing disclosure obligations, including updating past delinquent filings within 180 days;
- Cooperating with any subsequent SEC investigation regarding the reported false statements, including the roles of individuals and other parties involved;
- Disclosing in a clear fashion the settlement terms in any official statement for subsequent offerings by the issuer for the next five years; and
- Providing SEC staff with a compliance certification regarding the applicable undertakings by the issuer by the one year anniversary of the date proceedings were instituted against the issuer.

*No Civil Penalty.* The Enforcement Division will recommend a settlement in which there is no payment of a civil penalty by an issuer or obligated person participating in the MCDC Initiative.

### Underwriters

*Cease and Desist Proceeding.* The settlement will require an underwriter to consent to the institution of a cease and desist proceeding under which it will neither admit nor deny the findings of the SEC.

*Compliance Undertakings.* An underwriter participating in the MCDC Initiative will be required to implement the following undertakings to improve its continuing disclosure due diligence procedures, including:

- Retaining an independent consultant, not unacceptable to SEC staff, to conduct a compliance review and provide recommendations to the underwriter regarding underwriting due diligence processes and procedures within 180 days;
- Taking reasonable steps to enact the recommendations of the independent consultant, unless SEC approval is granted on the grounds that

compliance with certain recommendations would be unduly burdensome;

- Cooperating with any subsequent SEC investigation regarding the reported false statements, including the roles of individuals and other parties involved; and
- Providing SEC staff with a compliance certification regarding the applicable undertakings by the underwriter on the one year anniversary of the date proceedings were instituted against the underwriter.

*Civil Penalties.* The Enforcement Division will recommend a settlement in which an underwriter participating in the MCDC Initiative will be subject to the following civil penalties, with an aggregate limit of \$500,000 for all civil penalties under the MCDC Initiative:

- \$20,000 per offering containing a materially false statement for offerings of \$30,000,000 or less; and
- \$60,000 per offering containing a materially false statement for offerings of more than \$30,000,000.

The Enforcement Division advised that it will seek penalties in excess of those described above if violations not reported pursuant to the MCDC Initiative are subsequently discovered. Such penalties would likely include financial sanctions against issuers and obligated persons and increased financial sanctions against underwriters.

---

## Conclusion

Through recent enforcement actions and the implementation of the MCDC Initiative, the SEC is continuing its focus on promoting and enforcing continuing disclosure compliance under Rule 15c2-12 via the anti-fraud provisions of federal securities law. The MCDC Initiative is similar to the IRS Voluntary Closing Agreement Program (known as VCAP) in that it promotes regulatory compliance by offering self-reporting market participants favorable settlement terms. Given the relatively short timeframe for self-reporting under the MCDC Initiative, issuers and obligated persons will need to conduct an expedited review of their continuing disclosure compliance and disclosures, and underwriters will need to make a similar review of their verification of these disclosures, in order to evaluate their options under the MCDC Initiative.

---

## For More Information

*For more information, please contact your primary attorney at Chapman and Cutler LLP or visit us online at [www.chapman.com](http://www.chapman.com).*

This document has been prepared by Chapman and Cutler LLP attorneys for informational purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material.

© 2014 Chapman and Cutler LLP. All rights reserved.

Attorney Advertising Material.