

## MUNICIPAL LAW AND FINANCE

### SEC MUNICIPALITIES CONTINUING DISCLOSURE COOPERATION INITIATIVE UPDATE

Issuers and underwriters of municipal securities have been provided an opportunity by the U.S. Securities and Exchange Commission (the "SEC") to self-report violations of the federal securities laws relating to representations about continuing disclosures in bond offering documents in a program called the Municipalities Continuing Disclosure Cooperation Initiative (the "Initiative") announced by the SEC on March 10, 2014. Issuers may self-report by submitting the required questionnaire prior to 12:00 a.m. EST on September 10, 2014, if they may have made materially inaccurate statements in a final official statement regarding their prior compliance with their continuing obligations as described in Rule 15c2-12 under the Securities Exchange Act of 1934 (the "Exchange Act"). Underwriters may self-report by submitting the questionnaire by such date in connection with an offering they underwrote in which the final official statement contained materially inaccurate statements regarding an issuer's prior compliance with continuing disclosure obligations. Those issuers and underwriters who self-report may receive more favorable settlement terms with the SEC than will be available if the issuer or underwriter fails to self-report and the SEC later brings an enforcement action regarding the violations.

#### Background

Rule 15c2-12 generally prohibits an underwriter from purchasing or selling municipal securities unless the underwriter has obtained and reviewed an official statement that contains certain information about the securities being offered. The underwriter is also required to obtain a written commitment from the issuer to provide continuing disclosure regarding the securities and the issuer. The final official statement must disclose any instances in the previous five years in which the issuer failed to comply, in all material respects, with any previous commitments to provide such continuing disclosure.

In its release announcing the Initiative, the Division of Enforcement of the SEC (the "Division") stated that the Initiative is intended to address potentially widespread violations of the federal securities laws in connection with representations by issuers about continuing disclosures in bond offering documents. The release cited the example of a school district in Indiana (West Clark Community Schools) that the SEC charged, along with the underwriter, on July 29, 2013, with violating federal securities laws with respect to the school district's continuing disclosure representations in the official statement. The SEC charged that the school district and the underwriter falsely stated to bond investors that the school district had been properly providing annual information and notices as required in undertakings made by the school district in prior bond offerings. The school district and underwriter each consented to an order to cease and desist from committing or causing any violations of Section 10(b) of the Exchange Act and Rule 10b-5, and the underwriter also agreed to pay disgorgement and prejudgment interest of \$279,446 as well as a penalty of \$300,000.

The Division in the release stated that there is significant concern that many issuers have not been complying with their continuing disclosure obligations and that federal securities law violations involving false statements concerning such compliance may be widespread. Note that it is not solely the failure to comply with continuing disclosure obligations that is addressed by the Initiative; rather it is that failure coupled with the issuer's false statements in bond offering documents that it has complied with its prior obligations.

#### The Initiative

To be eligible for the Initiative, an issuer or underwriter must self-report by completing the questionnaire (which can be accessed on the SEC website or by clicking on <http://www.sec.gov/divisions/enforce/mcdc-initiative-questionnaire.pdf>) and submitting it to the SEC prior to 12:00 a.m. EST on September 10, 2014.

To the extent an issuer meets the requirements of the Initiative and the Division decides to recommend enforcement action against the issuer, the Division will recommend that the SEC accept a settlement that has the following features:

- The issuer consents to the institution of a cease and desist proceeding but neither admits nor denies the findings of the SEC.
- The settlement must include certain undertakings by the issuer relating to (i) establishing policies and procedures and training regarding continuing disclosure obligations, (ii) compliance with existing continuing disclosure undertakings, (iii) cooperation with any subsequent investigation by the Division regarding the alleged false statements, including the roles of individuals and/or other parties involved, (iv) disclosure of the settlement terms in any final official statement for an offering by the issuer within the next five years, and (v) providing the SEC staff with a compliance certification regarding the applicable undertakings by the issuer on the one-year anniversary date of the institution of the proceedings.
- There is no payment of any civil penalty by the issuer.

To the extent an underwriter meets the requirements of the Initiative and the Division decides to recommend enforcement action against the underwriter, the Division will recommend that the SEC accept a settlement that has the following features:

- The underwriter consents to the institution of a cease and desist proceeding and administrative proceedings but neither admits nor denies the findings of the SEC.
- The settlement must include certain undertakings by the underwriter relating to (i) retention of an independent consultant to conduct a compliance review and provide recommendations to the underwriter regarding its municipal underwriting due diligence process and procedures, (ii) taking reasonable steps to enact such recommendations, (iii) cooperation with any subsequent investigation by the Division regarding the alleged

false statements, including the roles of individuals and/or other parties involved, and (iv) providing the SEC staff with a compliance certification regarding the applicable undertakings by the underwriter on the one-year anniversary date of the institution of the proceedings.

- The underwriter consents to an order requiring payment of certain civil penalties based upon the amount of the offerings; provided, however, that the underwriter will not be required to pay more than \$500,000 in total.

The release addresses two additional items. First, the Initiative pertains only to issuers and underwriters. There is no assurance that individuals associated with those entities will be offered similar terms. The Division indicated that it may recommend enforcement action against such individuals and may seek remedies beyond those available through the Initiative. Second, the Division offers no assurances that it will recommend the settlement terms described in the Initiative to those issuers and underwriters that would be eligible for such terms if they do not self-report but are later charged with violations. In fact, the release states in those instances the Division will likely recommend and seek financial sanctions for issuers and financial sanctions for underwriters in amounts greater than those available pursuant to the Initiative.

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