

## **The Municipalities Continuing Disclosure Cooperation Initiative—What Is It and Does It Apply to Your District?**

*[Editor's Note: From time to time, we publish guest articles that we think inform readers on topics of interest. The article below by Jonathan Edwards and Sirikhwan Weaver, Government Financial Strategies inc., certainly meets this description. Necessarily, the views and opinions of the authors are their own, but we think the article below is interesting and informative.]*

On July 25, 2014, *The Fiscal Report* provided a very helpful summary regarding the Securities and Exchange Commission's ("SEC") Municipalities Continuing Disclosure Cooperation ("MCDC") Initiative. Also, in 2013, *The Fiscal Report* published two guest articles regarding the SEC's scrutiny of bond disclosure compliance and practical tips for effective continuing disclosure compliance, both of which are relevant to the MCDC Initiative.

Adding to this information, below is more detailed information regarding the MCDC Initiative, a flow chart for the steps to take to determine whether it may apply to your district, and issues to consider when seeking help.

### **Executive Summary**

Pursuant to issuing publically offered municipal securities (e.g., bonds with an Official Statement), issuers (e.g., school districts) undertake an obligation to file continuing disclosure reports on an annual and/or as needed basis. Also, an Official Statement must disclose every instance during the previous five years in which the issuer failed to materially comply with its continuing disclosure obligations.

The MCDC is an opportunity to self-report a "yes" answer to the following question: *Does an Official Statement for debt issued during the previous five years<sup>[1]</sup> materially misstate the issuer's compliance with continuing disclosure agreements during the five years preceding the date of the Official Statement?*

At the end of this article are steps an issuer can take to determine the answer to this question.

### **Background**

Under Federal law, underwriters may not purchase or sell publicly offered municipal securities (such as general obligation bonds, tax and revenue anticipation notes, etc.) unless they determine that the issuer will file continuing disclosure. To make this determination, underwriters require the issuer to sign a continuing disclosure certificate, which sets forth the requirements for filings.

In addition, any Official Statement associated with a publically offered municipal security must disclose every instance in the previous five years in which the issuer failed to materially comply with its continuing disclosure obligations. The SEC may file enforcement actions against issuers for inaccurate statements in this regard. For example, in 2013 the SEC charged the West Clark Community Schools in Indiana with fraud for falsely stating in an Official Statement that the school district had materially complied with continuing disclosure requirements.

Arising out of concerns that issuers were not disclosing failures to comply with their continuing disclosure obligations, in March of this year, the SEC announced its MCDC Initiative. The question posed by the

MCDC is: *Do any statements made in Official Statements during the past five years*<sup>[2]</sup> *materially misstate the issuer's compliance with continuing disclosure agreements in the five years preceding the date of the Official Statement?* If the answer is "yes", the SEC expects the details to be self-reported by issuers and underwriters.

The MCDC Initiative offers issuers and underwriters an opportunity to self-report instances during the previous five years where an Official Statement failed to disclose violations of the continuing disclosure requirement, in exchange for favorable settlement terms. Settlement terms of the MCDC initiative note, among other items, that there will not be a civil penalty for any reported violations, that the issuer must establish appropriate policies within 180 days and certify compliance within one year, and that the issuer must cooperate with any subsequent SEC investigation. Note that the initiative does not cover individuals involved with such violations. The SEC has indicated that there will be substantial enforcement activity once the MCDC initiative ends, with greater sanctions for violations.

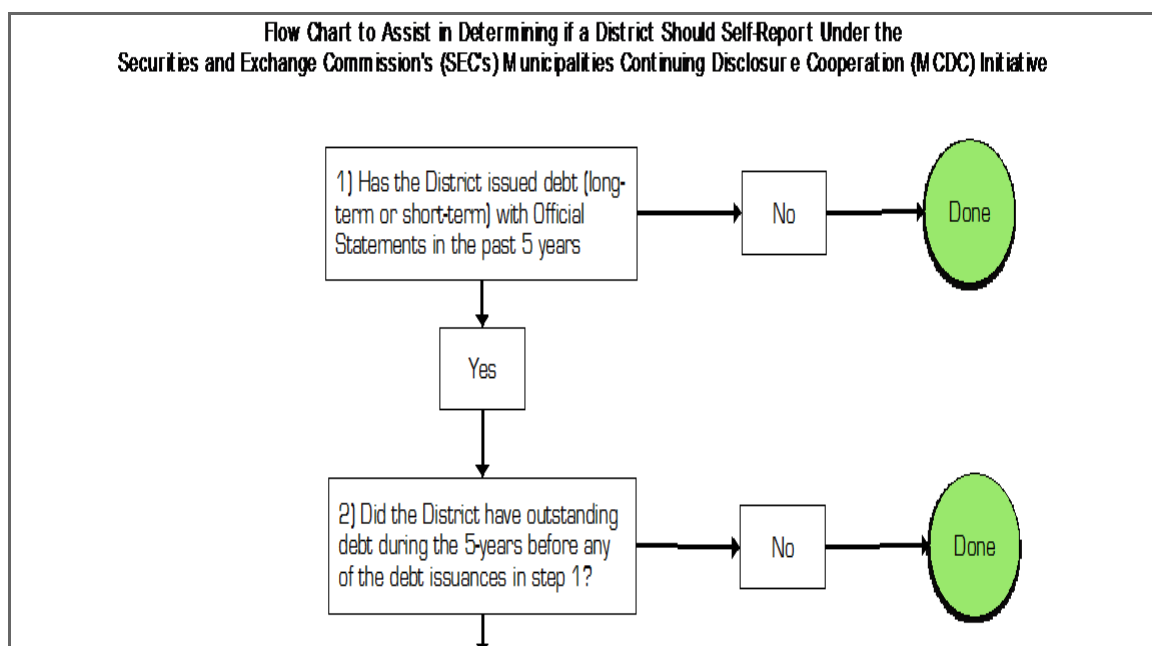
Originally, the SEC established a deadline for reporting under the MCDC initiative of 12:00 a.m. EST on September 10, 2014 (i.e. 9:00 pm PST on September 9, 2014). However, on August 1<sup>st</sup>, the SEC extended the deadline for issuers, but not underwriters, to December 1, 2014.

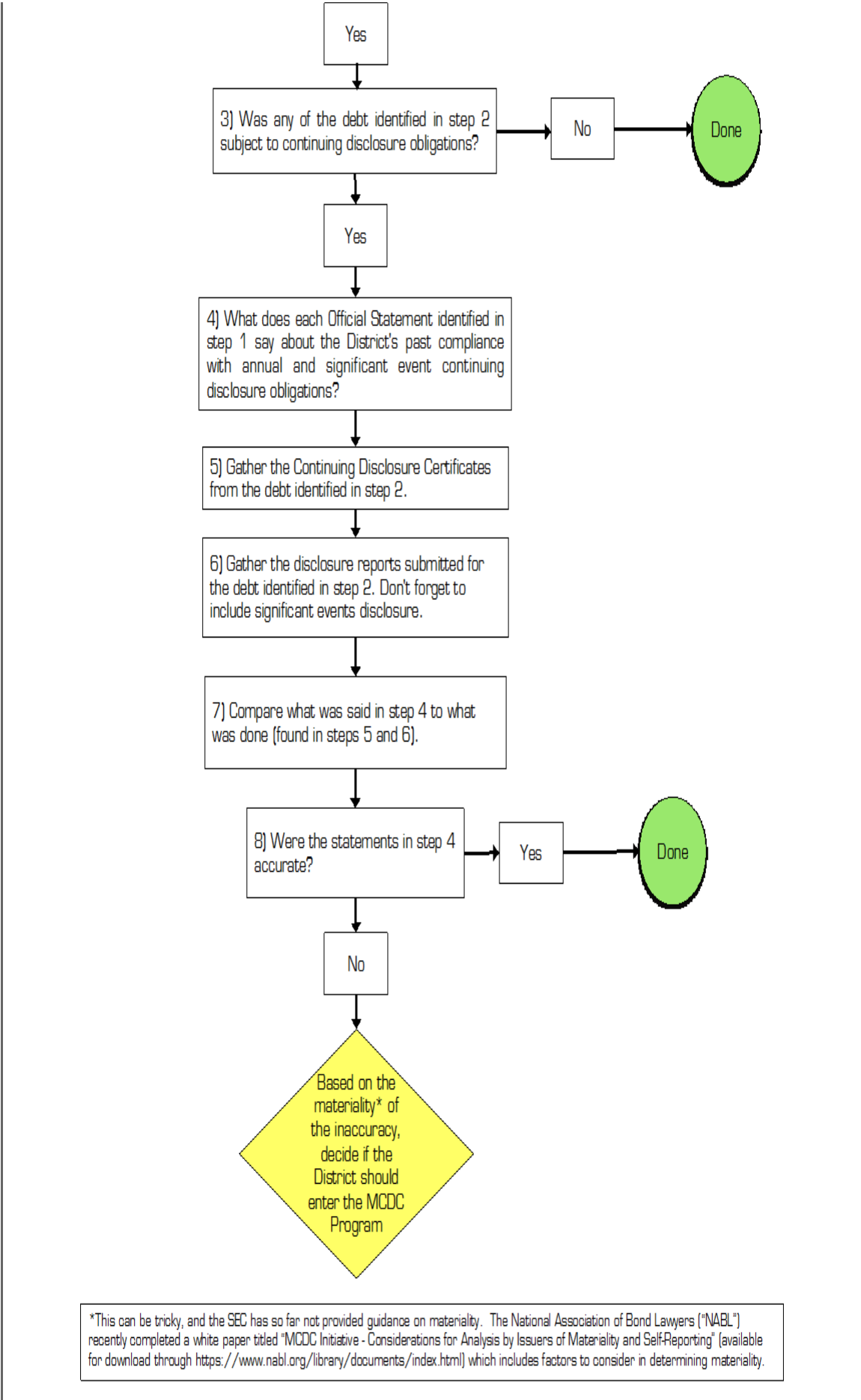
Under the MCDC Initiative, the SEC has created a "prisoner's dilemma" by requiring self-reporting by issuers and bond underwriters to identify all participants in the issue being reported, coupled with greater penalties on those identified by the SEC after the expiration date of the Initiative. We are increasingly seeing that underwriters are contacting issuers. A district should identify any relevant correspondence received (which could be from an underwriter or the SEC), promptly respond to any requests for information, and note if an underwriter has communicated that it is performing its own review and/or whether it plans to file under the Initiative.

Recently, the Kings Canyon Joint Unified School District (in Fresno and Tulare Counties) settled with the SEC under the MCDC Initiative. The SEC had charged the District with misleading bond investors in connection with a 2010 bond offering in which the District told investors it had complied with its prior continuing disclosure obligations. The SEC alleged that the statement was inaccurate because the District had previously failed to file some required disclosures. The District received the settlement terms described above.

## Checking Compliance

Many districts will be able to quickly eliminate or isolate any concerns on this topic. The flow chart below was created to assist school districts in conducting their own research. We hope that readers will use it, and let us know if it can be improved.





**Seeking Help**

This is an extremely complex issue, and for the sake of brevity, this article does not capture every nuance.

Further, the issue includes a significant risk - that of being charged with fraudulent activity. Therefore, issuers may wish to seek outside expert assistance. However, issuers should be careful about the qualifications of the firms, the nature of any contracts, and the fees charged. Also, after research has been completed and the facts clarified, it is important to consult with legal counsel in determining whether to participate in the MCDC.

Finally, the issuer is ultimately responsible under the MCDC Initiative, not the firms it may hire for assistance. Therefore, it is critical for issuers to be engaged at every step of the process.

—*Jonathan Edwards and Sirikhwan Weaver, Government Financial Strategies inc.*

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[1] There is a five-year statute of limitation for the SEC to file an enforcement action.

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