

Kern County Superintendent of Schools Understanding and Managing Debt Workshop

Municipalities Continuing Disclosure Cooperative (“MCDC”) Initiative



**Presented by Lori Raineri
November 6, 2014**

Agenda

- **Framework of Federal Regulation of Municipal Bonds**
- **SEC's Municipalities Continuing Disclosure Cooperative (MCDC) Initiative**
- **Considerations for How to Respond to MCDC**



The Stage Was Set In 1895

■ *Pollock v. Farmers' Loan & Trust Company*

- 1895 case began in New York, taken up by Supreme Court.
- Pollock owned 10 shares of the Loan & Trust and sued the company for payment of Federal income tax of his shares.
- Court ruled that Federal government taxation of dividends, real estate income, and interest (including municipal bonds) is unconstitutional.



Note: although Federal income tax was permanently established with the 16th amendment to the Constitution in 1913, income tax had previously been temporarily imposed in 1861 during the Civil War (repealed in 1862) and had been imposed in 1895 with the passage of the Wilson-Gorman tariff (which was subsequently ruled unconstitutional in the court case noted above).

Federal Reg. Begins in Earnest w/Crash



Securities and Exchange Acts

■ Securities and Exchange Act of 1933:

- Required investors to receive financial and other significant information on securities being offered for sale.
 - » Exemption for municipal, state, or Federal government
- Prohibited deceit, misrepresentations, and other fraud in the sale of securities.

■ Securities and Exchange Act of 1934:

- Created Securities and Exchange Commission
 - » Mission to protect investors.
- Rule 10b-5 strengthens anti-fraud provisions.
 - » *“It shall be unlawful for any person, directly or indirectly...to make any untrue statement of a material fact or to omit to state a material fact”*



Tower Amendment of 1975

- **Created the Municipal Securities Rulemaking Board (MSRB).**
 - **The MSRB has broad authority to write rules governing the activities of broker-dealers (and now municipal advisors) in the municipal securities market.**
 - **Rules enforced by the SEC.**



- **Prohibited Federal registration of disclosure for investors prior to the issuance of municipal securities.**

“Bearer” Bonds Tied to Money Laundering

The New York Times



Mystery of Fake U.S. Bonds Fuels Web Theories

By ELISABETTA POVOLEDO
Published: June 25, 2009

Ever since two middle-aged men with Japanese passports were caught in Italy this month trying to smuggle a purported \$134.5 billion in United States government bearer bonds into Switzerland, the Internet has been abuzz with theories.

Italian police seize \$6 trillion of fake U.S. bonds

BY ELISA FORTE AND GAVIN JONES
POTENZA, Italy | Fri Feb 17, 2012 5:27pm EST



Increasing Federal Regulation

- **Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)**
 - Municipal bonds issued after 1982 that are “bearer” bonds are not tax-exempt, requiring “registered” bonds.



- **Tax Reform Act of 1986 included:**
 - Limited use of municipal bonds for private purposes
 - Added rebate requirement for arbitrage earned
 - Limited advance refinancings to one opportunity

WPPSS: New Record for Largest Default

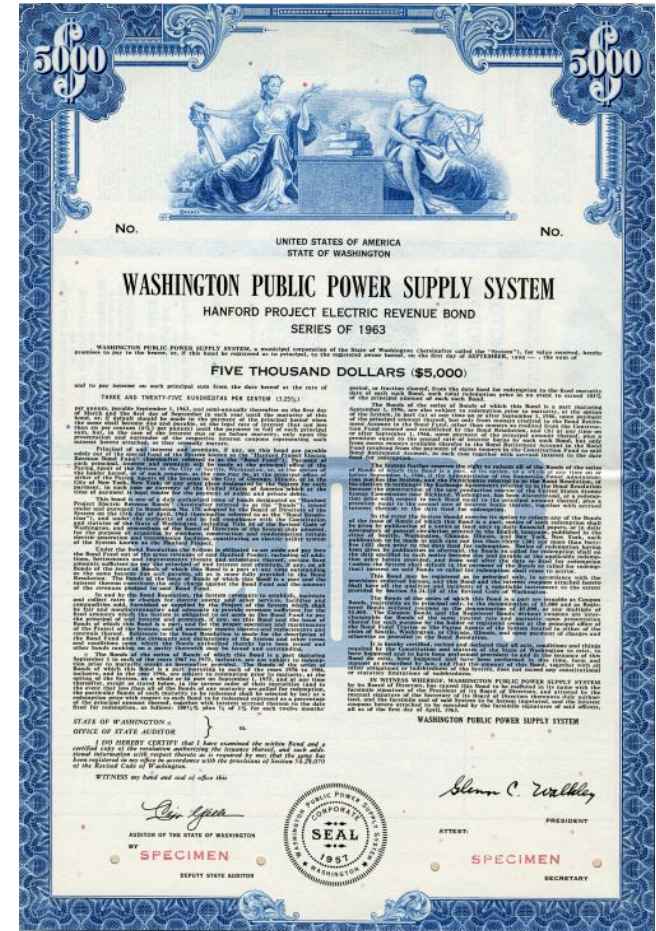


Whoops! A \$2 Billion Blunder: Washington Public Power Supply System

Fallout from a record default spreads from Washington State to Wall Street

By Charles P. Alexander | Monday, Aug. 08, 1983

- Two nuclear plants cancelled before construction completed (cost overruns, overoptimistic projections of demand for power).
- Contracts with 88 public utilities to buy power were defaulted upon.
- Many disclosure failures about projects and contracts.



Rule 15c2-12: Issuer Disclosure

- **Adopted in 1990 in response to WPPSS default.**
 - **No SEC enforcement actions taken in WPPSS, some Wall Street lawyers blamed this on the SEC being busy at the time with “junk bond king” Michael Milken, indicted for insider trading under RICO.**
- **Rule obligates broker-dealers/underwriters participating in new issuances of municipal bonds of \$1 million or more to obtain, review, and distribute to investors copies of the issuer's official statement.**
- **Although the SEC is prohibited from imposing disclosure rules on municipal governments, the SEC did so indirectly by placing the rules on broker-dealers/underwriters.**

Amendment Requires Continuing Disclosure

- **On November 10, 1994, the SEC amended Rule 15c2-12.**
 - Annual disclosure of financial / operating data
 - Notices of significant events (for example, rating changes)
- **A broker-dealer may not purchase municipal securities unless it makes a reasonable determination that there will be continuing disclosure.**
- **In 2009, the MSRB's Electronic Municipal Market Access ("EMMA") system became the sole repository for continuing disclosure filings.**
- **In 2010, the SEC said it is doubtful to make a reasonable determination there will be disclosure if the issuer has a history of persistent and material breaches or has not remedied past failures.**

Regulation Begins Anew with a Crash

THE WALL STREET JOURNAL.

Bernanke: 2008 Meltdown Was Worse Than Great Depression

By Pedro Nicolaci da Costa
August 26, 2014, 4:03 PM ET



Municipal Bond Market Impacted

City of Detroit



City of San Bernardino



County of Jefferson, Alabama



City of Stockton



West Clark Schools Charged with Fraud



TOP NEWS

UPDATE 2-Indiana school district, bond underwriter charged with fraud -SEC

Mon, Jul 29 17:42 PM EDT

WASHINGTON, July 29 (Reuters) - The U.S. Securities and Exchange Commission, pressing ahead with a crackdown on the municipal bond market, on Monday filed groundbreaking fraud charges that alleged an Indiana school district and its underwriter lied about financial information.

The West Clark Community Schools district failed to submit annual reports or notices required by statute for a 2005 bond issue and then, in an official statement for a 2007 bond sale underwritten by City Securities Corporation, said it had complied with disclosure obligations, the SEC said. Official statements summarize new bond sales for investors.

West Clark Schools – SEC Actions

- **Neither admitting nor denying charges, WCCS agreed to:**
 - Cease and desist violations
 - Implement written procedures
 - Provide annual trading
- **Underwriting firm was also charge with fraud**
 - Neither admitting nor denying charges, agreed to pay \$580,000 to settle.
- **The lead banker at the underwriter was charged with fraud and improper gifts (golf trips, sporting events, etc.)**
 - Neither admitting nor denying charges, agreed to pay \$38,000 to settle and was permanently banned.
- **This case spurred the SEC’s Municipalities Continuing Disclosure Cooperation Initiative.**

SEC's MCDC Initiative

- Announced on March 10, 2014, the Municipalities Continuing Disclosure Cooperation Initiative (MCDC) offers:
 - Issuers and underwriters the opportunity to turn themselves in for potential violations
 - In exchange for lighter punishments
 - Deadline of December 1, 2014
- The question presented by the MCDC is: *do any statements made in Official Statements materially misstate the issuer's compliance in the five years preceding the date of the Official Statement?*
 - If the answer is “potentially,” the SEC expects the details to be reported.

Prisoner's Dilemma

- The SEC created a “prisoner’s dilemma”
 - Requires self-reporting of both *issuers* and *underwriters* to identify all participants to a transaction
 - Greater penalties for those identified by the SEC after the offer’s expiration date



- ✓ *Underwriters have an incentive to report due to confusion, time pressure, and most importantly a cap on financial penalties.*

Caution is Advised



**U.S. SECURITIES AND EXCHANGE COMMISSION
DIVISION OF ENFORCEMENT**

**MUNICIPALITIES CONTINUING DISCLOSURE COOPERATION INITIATIVE
QUESTIONNAIRE FOR SELF-REPORTING ENTITIES**

NOTE: The information being requested in this Questionnaire is subject to the Commission's routine uses. A list of those uses is contained in [SEC Form 1662](#), which also contains other important information.

1. Please provide the official name of the entity that is self-reporting ("Self-Reporting Entity") pursuant to the MCDC Initiative along with contact information for the Self-Reporting Entity:
 - Individual Contact Name:
 - Individual Contact Title:
 - Individual Contact telephone:
 - Individual Contact Fax number:
 - Individual Contact email address:
 - Full Legal Name of Self-Reporting Entity:
 - Mailing Address (number and street):
 - Mailing Address (city):
 - Mailing Address (state):
 - Mailing Address (zip):
2. Please identify the municipal bond offering(s) (including name of Issuer and/or Obligor, date of offering and CUSIP number) with Official Statements that may contain a materially inaccurate certification on compliance regarding prior continuing disclosure obligations (for each additional offering, attach an additional sheet or separate schedule):
 - State:
 - Full Name of Issuing Entity:
 - Full Legal Name of Obligor (if any):
 - Full Name of Security Issue:
 - Initial Principal Amount of Bond Issuance:
 - Date of Offering:
 - Date of final Official Statement (format MMDYYYYY):
 - Nine Character CUSIP number of last maturity:

3. Please describe the role of the Self-Reporting Entity in connection with the municipal bond offerings identified in Item 2 above (select Issuer, Obligor or Underwriter):

- Issuer
- Obligor
- Underwriter

4. Please identify the lead underwriter, municipal advisor, bond counsel, underwriter counsel and disclosure counsel, if any, and the primary contact person at each entity for each offering identified in Item 2 above (attach additional sheets if necessary):

Senior Managing Underwriting Firm:
Primary Individual Contact at Underwriter:

Financial Advisor:
Primary Individual Contact at Financial Advisor:

Bond Counsel Firm:
Primary Individual Contact at Bond Counsel:

Law Firm Serving as Underwriter's Counsel:
Primary Individual Contact at Underwriter's Counsel:

Law Firm Serving as Disclosure Counsel:
Primary Individual Contact at Disclosure Counsel:

5. Please include any facts that the Self-Reporting Entity would like to provide to staff of the Division of Enforcement in understanding the circumstances that may led to the potentially inaccurate statements (attach additional sheets if necessary):

On behalf of _____
I hereby certify that the Self-Reporting Entity intends to consent to the applicable settlement terms under the MCDC Initiative.

By: _____
Name of Duly Authorized Signer:
Title:

Kings Canyon JUSD Charged Under MCDC

SEC Charges California School District with Misleading Investors

FOR IMMEDIATE RELEASE

2014-133

Washington D.C., July 8, 2014 — The Securities and Exchange Commission today charged a school district in California with misleading bond investors about its failure to provide contractually required financial information and notices. The case is the first to be resolved under a new SEC initiative to address materially inaccurate statements in municipal bond offering documents.

The SEC found that in the course of a 2010 bond offering, Kings Canyon Joint Unified School District affirmed to investors that it had complied with its prior continuing disclosure obligations. The statement was inaccurate because between at least 2008 and 2010, the school district had failed to submit some required disclosures. The California school district agreed to settle the charges without admitting to or denying the findings.

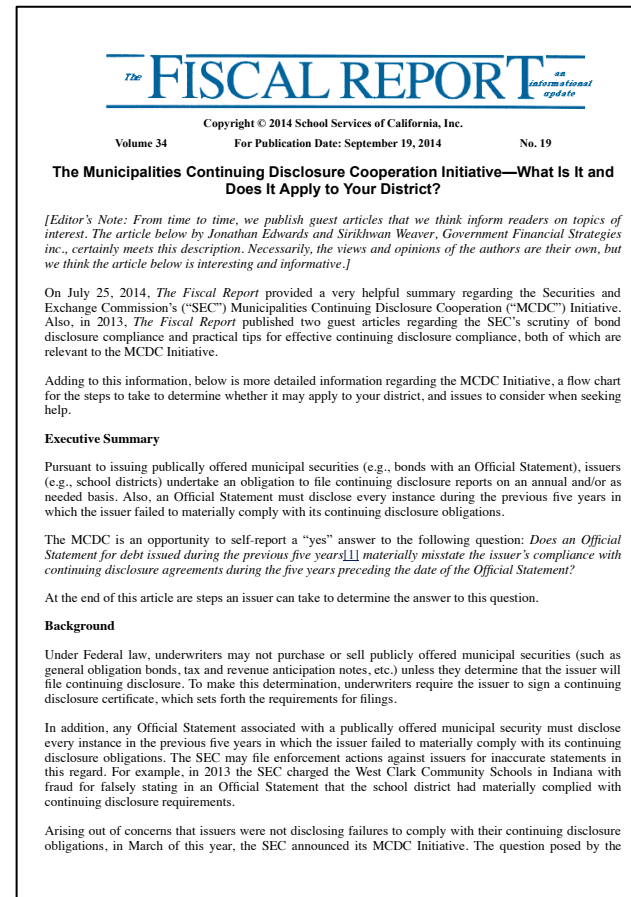
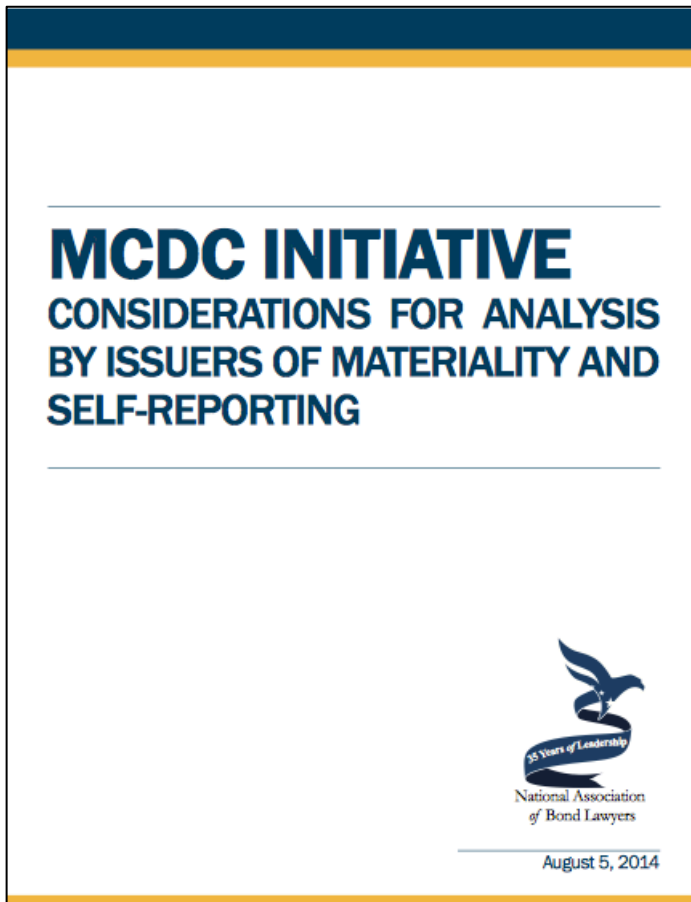
MCDC Settlement Terms

- **Consent to cease and desist violations.**
- **Neither admit nor deny the SEC findings.**
- **Not required to pay a civil penalty.**
- **Establish appropriate policies, procedures and training regarding continuing disclosure obligations.**
- **Comply with existing continuing disclosure undertakings within 180 days of the institution of the proceedings.**
- **Cooperate with any subsequent SEC investigation.**
- **Disclose the settlement terms in any official statement within five years of the institution of the proceedings.**
- **Provide a compliance certification on the one year anniversary of the institution of the proceedings.**



Actions in Response to MCDC Vary

- Early inaction to MCDC has resulted in improved guidance.
- Underwriter filings due September 9, 2014 have varied widely.



District Considerations

■ Knowing whether to report requires review of:

- continuing disclosure agreements (what was agreed to would be done)
- compliance history (what was actually done)
- Official statements (what was said was done)
 - » 5 years from earliest official statement over prior 5 years
 - » 10 year look back potentially
- any legal opinions on disclosure received



■ Measurement focus has changed:

- Prior focus was getting up to date and staying current
- New focus is what *was said* about prior compliance
 - » Confusion about misstatements, omissions, materiality

Next Steps

- An issuer may consider a review for MCDC by:
 - Reviewing in-house.
 - » We recommend the NABL paper and *The Fiscal Report* article.
 - Engaging professional assistance from the dissemination agent, financial advisor, underwriter, bond counsel or disclosure counsel.
- Having a record of review and consideration could help with future SEC inquiries.
- Questions and discussion?

