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Commentary

## MCDC Results Shed Light on SEC Views

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In responding to the Securities and Exchange Commission's recent Municipalities Continuing Disclosure Cooperation ("MCDC") initiative, the unanswered question for many market participants was determining whether failure to disclose certain conduct under an issuer's or borrower's (an "obligated person") continuing disclosure obligations constituted a "material" misstatement or omission. The SEC has released the results of two rounds of settlements with broker dealers under the MCDC initiative which provide guidance concerning the SEC's views regarding materiality under continuing disclosure obligations.

The majority of the cited failures to meet the requirements of Rule 15c2-12 would have been considered material by most participants in the municipal market. These include, for example, a complete failure to file any annual financial information and filings that were months late, often consistently so. Generally, where there was failure to file in a timely manner, obligated persons also failed to file a notice with EMMA of such failure, as required under the Rule.

Other than the failure to file a notice of a late or missed filing, however, no other failures to file event notices have been cited in the settlements.

Additional instructive guidance from the settlements relates to failures to disclose certain downgrades to bond ratings. The Rule requires that a notice must be filed when a rating changes to a municipal security. Many obligated persons filed such event notices when the rating on their bonds was downgraded due to the reduction in the rating of an insurer of such bonds. Other obligated persons did not make such a filing, generally after determining that such a filing would not be material given the widespread public knowledge of the downgrades. Although a definitive conclusion cannot be drawn, the SEC's failure to cite the lack of notices of downgrades on bond ratings due to such bond insurers' downgrades does provide some comfort to those obligated persons that determined that failure to make such a filing was not a material omission.

One of the most hotly contested questions regarding materiality was how late a filing could be made before the lateness of the filing constituted a material failure to comply with the requirements of a continuing disclosure obligation. In only one case was a late filing of less than 30 days cited (the filing was not only 16 days late, it was also incomplete), and in most cases, the obligated person's filings were not only much more than 30 days late, but there were multiple late filings, and notice of late filings were not made.

Filings compliant with Rule 15c2-12 may be made by reference to other filed documents. However, a failure to make a filing with respect to each separate issue of municipal securities

that cross references a recent filing can constitute a failure to file. EMMA references municipal securities by the separate series or bond issue and by CUSIP number. Thus, obligated persons must ensure that an appropriate cross reference citing the location of the referenced document is made with respect to each series of securities to which such requirements applies.

Another oft-cited failure was the failure to include the operational data required under a continuing disclosure obligation with an annual filing.

Lastly, the SEC settlements make clear that a material omission is not cured unless the omitted disclosure is filed with EMMA for each municipal security subject to a continuing disclosure undertaking, a notice of the previous failure to file is also filed with EMMA, and the Official Statements for the obligated person for the ensuing five years disclose the prior failures to file.

Cited misstatements or omissions within the last year decreased significantly. This generally is consistent with the view that the participants in the municipal market are now highly sensitized to the importance of complying with their obligations under Rule 15c2-12 and may also indicate that the SEC's primary goal of the MCDC initiative – enhancing compliance with continuing disclosure obligations – has been realized.

Based upon these settlements, we recommend that obligated persons consider taking each of the following steps:

- Review the continuing disclosure obligation relating to each series of outstanding municipal securities and be familiar with the information that must be provided annually, and quarterly in some cases, and the events that must be disclosed. Consider setting up a "tickler" in the calendar of the officer responsible for making such filings – note that EMMA has recently added that capability to its system.
- Adopt disclosure policies and procedures that are consistent with the SEC's recommendations. These include designating a person responsible for such filings and providing for regular training of the persons that prepare disclosure. In addition, requiring that these policies be reviewed and updated or re-authorized on a regular basis leads to enhanced compliance with and awareness of disclosure requirements.
- If a deadline for a filing is missed, make the filing as soon as possible, along with a notice of the failure to file. A slightly late filing may not constitute a material failure under Rule 15c2-12.
- Finally, ensure that annual filings and applicable event notices are filed with EMMA for each of the applicable municipal securities, or that appropriate cross references are filed.

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