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Mastering Disclosure in a Post-MCDC World

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Vice President
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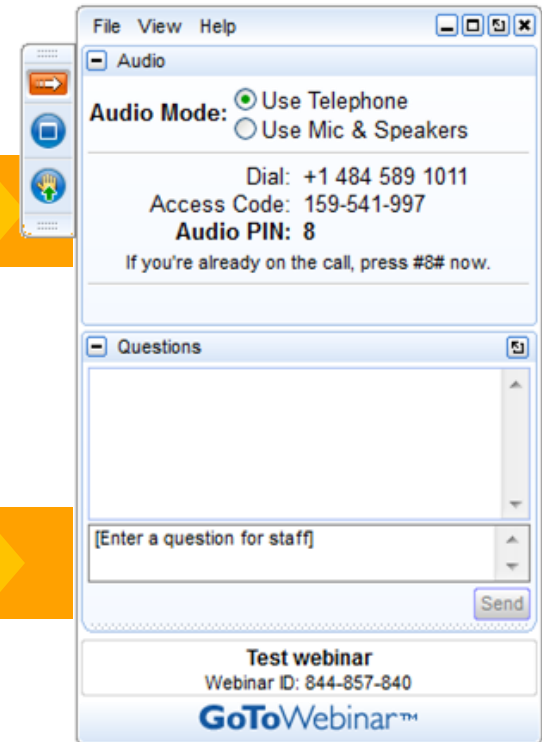
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Mastering Disclosure in a Post-MCDC World: Hot Topics in Enforcement

July 14, 2015

Katten

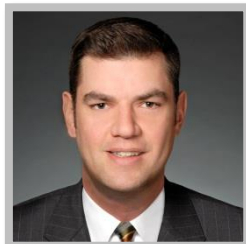
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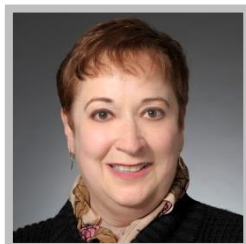
Hot Topics in SEC and IRS Bond Enforcement

MCDC Panel



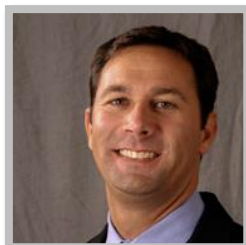
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Michael Diver is the head of Katten's Chicago Securities Litigation and Enforcement practice. A former Branch Chief in the Division of Enforcement of the SEC's Chicago Regional Office, Diver's experience covers virtually all areas of capital markets regulatory enforcement, including municipal securities transactions and disclosure. He also regularly advises clients in connection with SEC regulatory examinations, and Financial Industry Regulatory Authority, Inc. (FINRA) and stock exchange inquiries.



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Jeff Higgins serves as managing director at the Los Angeles office of BLX. He is primarily focused on the marketing and execution of numerous pre-issuance and post-issuance advisory services including financial advisory, investment advisory, verification agent services, structured product and escrow bidding agent services, arbitrage rebate, and municipal continuing disclosure, among others.



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Janet Goelz Hoffman is a partner in Katten's Public Finance practice who concentrates on the use of financial products in the public finance markets. She regularly acts as bond counsel, underwriter's counsel, borrower's counsel or credit enhancer's counsel in financings for nonprofit organizations including municipalities, hospital systems, cultural and educational institutions, and continuing care retirement communities. She also advises nonprofit organizations on board governance, disclosure and conflict of interest issues.

MCDC Initiative

- In March 2014, SEC established the Municipal Continuing Disclosure Cooperation Initiative (“MCDC”)
- Self-reporting program available to issuers, obligors, and underwriter’s
- Self-Report to the SEC regarding material misstatements made in official statements regarding an issuer’s prior compliance with continuing disclosure undertakings
- Deadline to self-report were September 10, 2014 for underwriter’s and December 1, 2014 for issuers and obligors
- Settlement terms under the MCDC program were provided
- SEC indicated that if it found material misstatement that were not reported, sanctions would be more severe
- In June 2015, SEC announces first wave of underwriter settlements under the MCDC Initiative

MCDC Initiative

- Settlement Terms for Issuers/Obligors
 - consent to “cease and desist” proceedings
 - establish policies and procedures and training regarding continuing disclosure within 180 days
 - correcting past delinquent filings within 180 days
 - disclose the settlement terms in future official statements over the next five (5) years
 - provide compliance certification to SEC within one (1) year
 - cooperate with any SEC investigation, including roles of individuals/other parties
 - NO CIVIL PENALTY

MCDC Initiative (continued)

- Settlement Terms for Underwriters
 - consent to “cease and desist” proceedings
 - retain an independent consultant (“IC”) to conduct a review and provide recommendations regarding underwriting due diligence process and procedures
 - enact IC recommendations within 90 days
 - cooperate with any SEC investigation, including roles of individuals/other parties
 - provide compliance certification to SEC within one (1) year
 - CIVIL PENALTIES – between \$20K-\$60K per violation, \$500,000 cap
- NO PROTECTION FOR INDIVIDUALS

Take Aways From MCDC

Limits of Settlement Terms

- Only disclosed violations that aggregate to maximum settlement amount
- May represent most egregious violations
- Definition of materiality still elusive

Materiality

- Even though we cannot describe it well, do we know it when we see it?

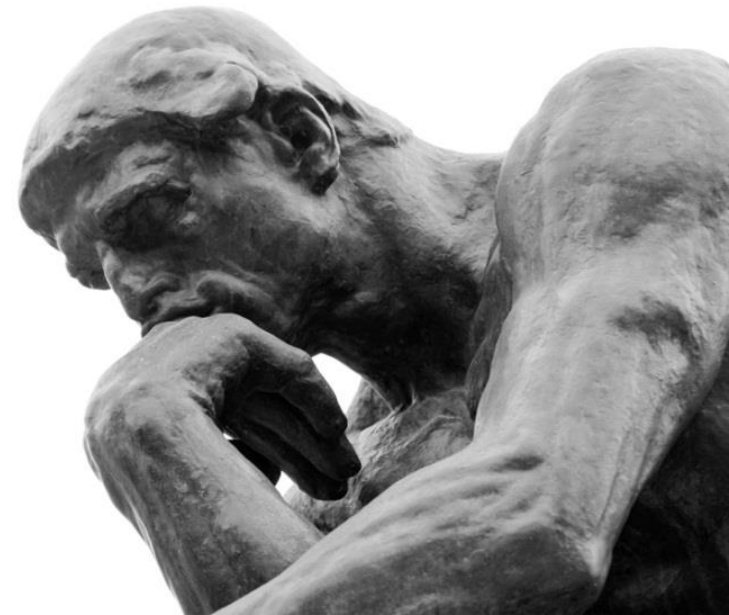


The SEC's Settlements Disclosed Worst Cases

- Negotiated deals were mostly noticed compared to competitively sold issues
- The nuances of where materiality begins generally not addressed

What's on the SEC's Mind?

- Missing filings
- Late filings
- Failure to cross reference any public filings
- Failure to file notice of past failures



Surprises

- Notices for failure to file or file on time important to SEC
- Failure to “cross reference” within the EMMA system creates a violation even though information available on EMMA in other format
- Quarterly financials important if issuer committed to provide, even though rule doesn’t require it
- No event notices cited for rating changes or defeasances

Best Practices as a Result

- Issuers must know and monitor their compliance history
- Don't be surprised at the importance underwriters place on compliance
- Offering document should expressly disclose status of compliance over prior five year period
- Materiality is elusive. When in doubt, disclose any lack of perfection

Issues of Compliance for Underwriters and Issuers After MCDC

Post MCDC Compliance/Underwriters

- Independent Consultants are required by the SEC for those underwriters that participate in MCDC
- Focus on qualifications and independence
- SEC enforcement staff vetting candidates now
- 180-day reporting time period in settled order driving timing of retention
- Multiple firms offering services

Post MCDC Compliance/Issuers

- Need to know their history of compliance or noncompliance
- Provide that history to each Underwriter
- Underwriters will typically independently verify Issuer's compliance
- If remedial action to bring into compliance hasn't been taken, Underwriters will likely require it now

Post MCDC Compliance

- Issuers and Borrowers must have their compliance procedures in place whether or not they participated in MCDC
- Underwriters must have their compliance procedures in place whether or not they participated in MCDC
- BETTER SAFE THAN SORRY!
- SEC and FINRA scrutiny in this area will continue

Hot Topics in SEC and IRS Bond Enforcement

Issue Price Panel



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Sandee Stallings is a senior member of the BLX management team who brings more than 23 years of arbitrage and public finance experience to the panel. She also serves as the business group leader of BLX's Compliance Services, which encompasses Arbitrage Rebate and Yield Restriction Compliance, Post Issuance Compliance, Secondary Market Disclosure and Program Administration Services. Sandee is an industry leader in monitoring compliance as it relates to tax-exempt financings for all types of issuers of municipal bonds.



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Milton Wakschlag heads Katten's Public Finance federal tax law practice. In that capacity, he concentrates his practice in the areas of tax-exempt debt financings of all kinds, IRS bond audits and private rulings, public-private partnerships, financial derivatives, and post-issuance compliance. He has served on numerous boards and committees and appears regularly as a speaker and author in the tax-exempt finance area.

Purpose of Issue Price Rules

- Establish bond yield (*e.g.*, for advance refundings or rebate)
- Establish base for measurement of use of proceeds tests (*e.g.*, 10% private business use or 10% debt service reserve fund)
- Determine whether the bonds bear original issue discount or premium (may have a different definition of issue price)



1993 Regulations

- Determined by first 10% of each maturity
- Based on reasonable expectations as of sale date
- Problem: actual bond pricing between bond sale and delivery sometimes trends higher than sale date expectations
- Status: current law

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"Whoops! There go those darned interest rates again!"

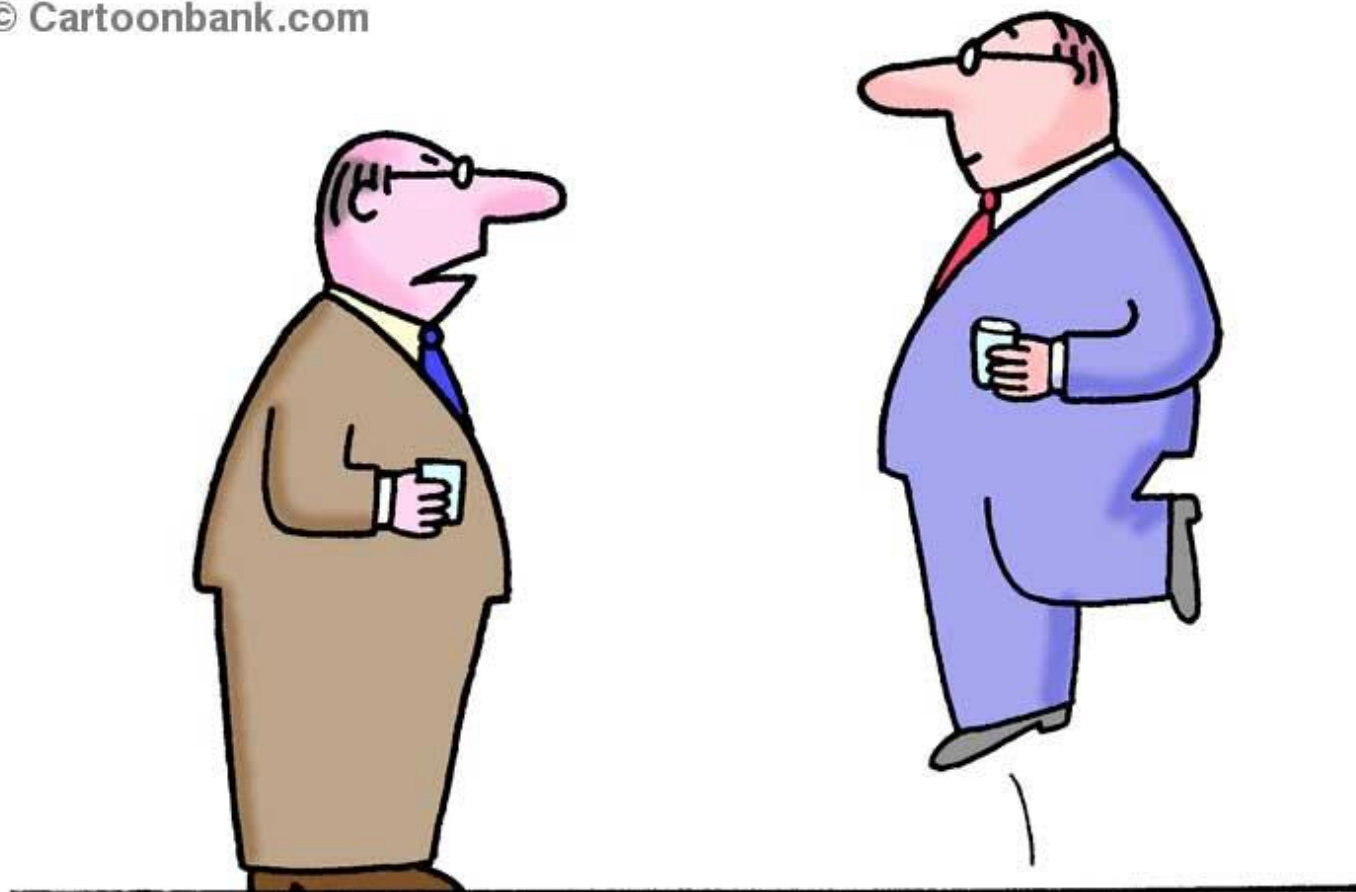
2013 Proposed Regulations

- Determined by first 25% of each maturity
- Based on actual sales (not reasonable expectations)
- Problem: encourages underpricing bonds to meet 25% threshold
- Status: withdrawn

2015 Proposed Regulations

- Determined by first 10% of each maturity
- Based on (a) actual sales or (b) sale date expectations if, among other things, lead underwriter certifies that “no underwriter will fill an order placed by the public and received after the sale date and before the issue date at a price higher than the initial offering price, except if the higher price is the result of a market change (such as a decline in interest rates) for those bonds after the sale date”
- Problem: in order to avoid certification, encourages (a) underpricing bonds to meet 10% threshold, or (b) minimizing period between bond sale and delivery, or (c) failing to underwrite unsold bonds
- Status: may be relied on now (*e.g.*, to avoid IRS second-guessing sale date expectations)

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C. Barzotti

**"Must you do that every time I say
interest rates are bound to rise?"**

How to Fix the Proposed Regulations

- Comments invited; e.g.- “on other safeguards or alternative approaches to ensure that the prices obtained by underwriters in actual sales of bonds to the public between the sale date and the issue date are consistent with use of initial offering prices to the public as of the sale date as a simplifying assumption for issue price determinations in the alternative method”
- Alternative: stick with current regulations; leave mis-pricing issues (if any) to SEC

"It's funny how two intelligent people can have such opposite interpretations of the tax code!"

Application and Real World Implications

- Ideal would be to have fixed yield bond that is determinable at closing / sale date and never changes, and that is generally attainable, except for limited circumstances
- Issuer would aim for highest sales price (greatest proceeds), therefore paying lowest yield (contrarily, lower price leads to higher overall cost of borrowing)
- Lowest yield rule of thumb aligns with purpose of arbitrage provisions to minimize arbitrage investment benefits and removes incentives to issue more tax-exempt bonds and therefore in turn limits Federal subsidy
- Even if substantial amount of the bond is not sold by sale date, then the alternative method may still allow you to treat initial offering price to the public as the issue price of the bond if certification requirements are met
- Issuer needs to retain documentation to support issue price determinations in the event of an audit – both original general rule application (10% offering substantiation) and / or certifications of alternative method

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Tuesday, August 18 @ 1:00 pm EDT

► CDFA Kentucky Webcast: Understanding the EB-5 Model in Kentucky

Wednesday, August 19 @ 11:00 am EDT

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