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GFOA's Watkins: MCDC Cost Issuers; SEC Initiative 'An Abuse of Power'.

PHILADELPHIA — Municipal issuers spent $2,000 to $18,000 to do continuing disclosure reviews under the Securities and Exchange Commission's Municipalities Continuing Disclosure Cooperation Initiative and the vast majority of them felt they were forced to do them, the Government Finance Officers Association said during a spirited panel discussion here Tuesday.

The cost estimate resulted from a survey that GFOA released in conjunction with an MCDC panel discussion at the group's annual conference here.

The survey's results showed that 79% of responding issuers had to hire outside consultants to help them at costs ranging from $2,500 to over $12,000. Some issuers spent as much as $18,000 or as little as $2,000 to do the disclosure reviews. The survey results also showed issuers spent between 25 and 250 hours responding to the initiative. In addition, 65% of issuers who responded to the survey self-reported potential violations under the MCDC, and 69% felt that responding to the initiative was required, not voluntary.

That initiative encouraged issuers and dealers to voluntarily report to the SEC any time in the last five years in which they sold or underwrote bonds with offering documents that did not identify recent failures to comply with issuers' continuing disclosure agreements as required by the SEC's rule 15c2-12. The MCDC reporting period expired on Sept. 10 last year for underwriters and on Dec. 1 for issuers.

Ben Watkins, the director of Florida's division of bond finance and chair of the GFOA's debt committee, said the average cost for issuers was almost $6,000, but warned that the sample size was not large enough to be scientific.

Watkins sparred over the initiative with LeeAnn Gaunt, chief of the SEC enforcement division's municipal securities and public pensions unit. "There was nothing either voluntary or cooperative about the initiative," Watkins said, labeling the MCDC "an abuse of power" by the SEC.

Watkins said the initiative was especially problematic for issuers because they effectively were forced to dig through voluminous lists of potential violations supplied to them by their underwriters. Some of these violations occurred in the pre-EMMA era, Watkins said, meaning that issuers had to comb through a user-unfriendly system riddled with inaccuracies to try to prove their innocence.

"That doesn't seem right to me," Watkins said.

But Gaunt responded strongly to Watkins' words, calling his criticisms "red herrings." Gaunt said issuers shouldn't expect the SEC to tailor its activities to what is convenient for them.

"The enforcement division is here to prosecute historical violations of securities laws," she said.

Gaunt posed a rhetorical question to the crowd, asking them whether they had really been thinking

about their disclosure compliance when they signed off on official statement language that said they had been in material compliance. If they had been sloppy, that was their fault, she said.

“How is that my problem?” Gaunt asked.

Kristi Kordus, finance director at Marathon County, Wisc. said on the panel that her county participated in the MCDC at a cost of $7,500 but that she got “priceless” peace of mind as a result.

John McNally, a partner at the law firm of Hawkins Delafield & Wood in Washington, said the MCDC was the result of the SEC’s lack of authority to regulate issuers beyond the antifraud provisions of the securities laws. The Tower Amendment, added to the securities laws in the mid-1970s, forbids the SEC from requiring issuers to directly or indirectly file reports or documents with it before issuing bonds.

“I think you best view it as a product of that structure,” McNally said, noting that the SEC had warned the market it could take action like this, particularly in a 2012 risk alert that warned underwriters about violations of 15c2-12.

Though there is some issuer concern that the SEC could seek repeal of Tower based on the potential violations reported under the MCDC, McNally said he guessed any such attempt would fail as it has before.

Dave Sanchez, an attorney at Sidley Austin in California who is a former SEC muni office lawyer, said the SEC carefully considers where to spend its scarce resources.

“Did it accomplish bang for the buck? I think, honestly, it did,” Sanchez said. “Behavior is changing,” he said, adding, “That’s a positive thing.”

But Sanchez said also that the SEC has to consider whether issuer disclosure is the most pressing problem in the market. He said the SEC might want to consider next turning to new rules, effective June 15, which require credit rating agencies to apply ratings universally to all securities they rate. As of now, munis default far less often than similarly-rated corporate debt.

The GFOA conference concludes on Wednesday.

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