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Foley & Lardner: The MCDC Initiative and Recent Modifications.

The MCDC Initiative And Recent Modifications: Window For Issuers And Obligated Persons Now Closes On December 1, 2014, While Underwriters Window Still Set To Close On September 9, 2014

As highlighted in the SEC's 2012 Municipal Market Report, the SEC has expressed significant concern that many issuers have not been complying with their obligation to file continuing disclosure documents and that federal securities law violations involving false statements concerning such compliance may be widespread. Increasingly, the SEC also has been taking enforcement actions under either Section 17(a) of the Securities Act of 1933 and/or Section 10(b) of the Securities Exchange Act of 1934 against issuers or obligated persons (collectively, "Borrowers") for inaccurately stating in final official statements that they have substantially complied with their prior continuing disclosure obligations.

The SEC's Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative"), announced on March 10, 2014, is intended to address potentially widespread violations of the federal securities laws by issuers and obligated persons involved in the offer or sale of municipal securities (collectively, "issuers") and underwriters of municipal securities in connection with certain representations about continuing disclosures in bond offering documents. The SEC recently announced certain modifications to the MCDC Initiative. This Alert summarizes those modifications. Reference is made to our first Alert on the MCDC, a copy of which can be obtained on Foley.com.

SEC Enforcement Division Modifies MCDC Initiative

On July 31, the SEC announced two primary modifications to its MCDC Initiative: first, to allow issuers and obligors more time to complete their reporting requirements, the division has extended the deadline for Borrowers — but not underwriters— to self-report potential violations from September 10, 2014 to December 1, 2014; and second, with respect to underwriters, the division has determined to implement a tiered approach to civil penalties based on the size of the firm, in order to encourage smaller underwriters to participate in the initiative.

The deadline for underwriters remains unchanged at September 10, 2014 (actually midnight on September 9th).

The division's tiered approach to the cap on civil penalties for eligible underwriters is as follows:

- For underwriters with 2013 reported total annual revenue of more than \$100 million: \$500,000
- For underwriters with 2013 reported total annual revenue between \$20 million and \$100 million: \$250,000
- For underwriters with 2013 reported total annual revenue of less than \$20 million: \$100,000

The SEC also acknowledged difficulties with the NRMSIR filing system that predated the current EMMA system maintained by the MSRB. The division states that parties may use "reasonably

available sources of information to make good faith efforts to identify potential violations but may not be able to identify certain violations during the period of the initiative due to the limitations of the pre-EMMA NRMSIR system. Potentially mitigating the lack of certainty due to the inconsistency of filings with the NRMSIRS, the division has stated that it “will consider reasonable, documented, good faith, and documented efforts in deciding whether to recommend enforcement action and, to the extent enforcement action is recommended, in determining relief.”

For a variety of reasons, including the SEC’s often stated views on the manner in which underwriters may comply with Rule 15c2-12, together with this tiered fee structure, we anticipate that underwriters will take advantage of this self-reporting program and scrutinize a Borrower’s prior disclosures and possible failures to comply. We note that some market participants have expressed concern that the tiered cap will encourage even more reporting by underwriters of borderline disclosure failures, thus enhancing the tension created by the “modified prisoner’s dilemma” of the original MCDC Initiative.

The two and a half month delay in the reporting deadline for Borrowers, will allow for a greater period of time by such Borrowers to understand potentially material misstatements or omissions that may have been disclosed to the SEC by its underwriter.

The MCDC Initiative

Our recommendations related to initial steps to be taken by a Borrower stated in our first Alert, remain the same. We continue recommend that Borrowers take the following steps to determine whether to opt into the MCDC program:

- Borrowers should first review their Official Statements for the past 10 years to determine what was said about continuing disclosure. Borrowers also should note the underwriters of each series of bonds.
- Borrowers next should review their undertakings to determine the scope of their continuing disclosure responsibilities.
- Borrowers then should review the filings actually made. This review should cover both the (1) timely filing of reports and (2) the substance of the reports (making sure the information furnished is that required to be filed); but also (3) the filing of material event notices.

If a Borrower determines that there is a potentially material misstatement in an Official Statement (for example, the Borrower has not described any failure to comply with a continuing disclosure undertaking), then they should consult with counsel to determine, first, if such misstatement was material, and if so, whether to file under the MCDC.

Notwithstanding the foregoing, we strongly encourage Borrowers to coordinate their review with the underwriters of each series of bonds referenced in (i) above. Because the window for self reporting by underwriters closes before the December 1 deadline applicable to Borrowers, Borrowers will need to understand what action (if any) an underwriter has taken with respect to the Borrower’s outstanding disclosures.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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