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How MCDC Has Changed Continuing Disclosure Practices.

LOS ANGELES – Municipal market participants here shared concrete examples of how disclosure is improving in the wake of the Securities and Exchange Commission's continuing disclosure voluntary enforcement initiative.

They pointed to the increased use of third party consultants and better written policies and procedures during a Tuesday panel focused on the effects on disclosure of the SEC's Municipalities Continuing Disclosure Cooperation initiative at The Bond Buyer's California Public Finance Conference.

They gave their examples during a Tuesday panel focused on the effects on disclosure of the SEC's Municipalities Continuing Disclosure Cooperation initiative at The Bond Buyer's California Public Finance Conference.

The MCDC initiative promised underwriters and issuers would receive lenient settlement terms if they self-reported instances over the last five years where issuers falsely said in offering documents that they were in compliance with their continuing disclosure agreements.

The commission most recently announced 71 settlements with issuers from 45 states on Aug. 25. Those issuers joined 72 underwriters that represented 96% of the underwriting market by volume and paid a combined $18 million as part of their MCDC settlements. It is unclear if the SEC plans to pursue additional issuer settlements.

Cyrus Torabi, a shareholder with the law firm Stradling Yocca Carlson & Rauth and moderator for the MCDC panel, said along with other panelists that the initiative has succeeded by focusing the muni industry's attention on disclosure in a way it had not been focused before.

"One thing that I have certainly noticed is that on almost every deal, there is a third-party consultant," he said. "Most underwriters require that. It's basically a market practice."

Torabi compared that general standard with one he remembers when he first started in munis. He said there would be a brief question on a phone call about whether the issuer had been in compliance with prior disclosure requirements. If the issuer said yes, that was enough to put it in the official statement.

Torabi and Eric Goldstein, principal administrative analyst with the Metropolitan Water District of Southern California, also said that underwriters as well as disclosure and underwriter's counsel have generally heightened their scrutiny of official statements.

Goldstein cited as an example a recent due diligence call he was on where close to half of the 38 written questions focused on disclosure. He added that the metropolitan water district did not file under MCDC.

Stephen Heaney, director of public finance for Stifel, said his firm, which paid $500,000 in a settlement under MCDC, has a new focus on due diligence in the aftermath of the voluntary

enforcement program “in order for the SEC not to come back and get us again.”

Torabi said one idea for firms and issuers to consider when thinking about strengthening future disclosure is to be clearer about when the information will be filed. Many times, an issuer’s disclosure undertakings say that it will file its continuing disclosure information something like six months or 180 days after its fiscal year ends, he said.

“Those types of deadlines create ambiguity,” he said. Instead, firms should set an “actual, hard date” and stick to it, Torabi added. Several market groups, including the National Federation of Municipal Analysts, have suggested that in the past.

Torabi also noted that the SEC’s Rule 15c2-12 on disclosure requires the filing of audited financial statements, but not necessarily the full audited annual financial report. He recommended that one way for issuers to minimize liability would be to only file updated financial information instead of its entire comprehensive audited financial report as part of their continuing disclosure.

Heaney said that there should be discussions about what to include in disclosures from a financial perspective leading up to the filing of the primary offering document.

“If something was important enough to be put in the initial offering [documents] and it’s financial, then it really ought to be available to those in the secondary market,” Heaney said.

Bill Oliver, NFMA’s industry and media liaison who was in the audience during the panel, said he agrees with Heaney about information that is material for primary market investors being material for secondary market disclosure.

“This is essential for maintaining bond market liquidity,” he said.

Oliver added that the main lesson from MCDC is that compliance with secondary market disclosure needs to be taken seriously by issuers and that the idea of providing less about financial information and other relevant areas is flawed.

“Any suggestions that issuers provide less information to the market fails to understand the message that the SEC is sending in its MCDC program,” Oliver said. “The market needs more complete and timely financial information for the secondary market to function properly. The emphasis should be on providing more relevant information as quickly as soon as possible to the market, not in reducing issuer disclosure to diminish future liability.”

Heaney also addressed the idea of participants trying to determine what the SEC considers material under its Rule 15c2-12 requirements, saying the idea “seems to be continuing to be nebulous.” He urged underwriters and issuers to take an attitude of “if you’ve got mistakes, lay them out.”

During a separate panel later in the day, Mary Simpkins, senior special counsel with the SEC’s Office of Municipal Securities, briefly addressed the question of materiality by pointing out the examples of actionable conduct listed in the commission’s 143 MCDC settlements.

“With respect to MCDC, I think we have already given you 143 examples of situations which we have found to be material,” she said. “No matter how much guidance we put out, it’s never going to cover everything. If you’re not sure, just disclose it. You don’t have to figure out exactly where the line is.” In the first panel, speakers also touched on good guidelines issuers can have in place regarding disclosure.

Goldstein and other panel members highlighted the importance of written policies and procedures

for issuers, something he said the metropolitan water authority has had formally since 2013. Its procedures outline the information that will be in annual filings, what triggers the need for a material event notice, as well as the duties of staff in preparing and filing disclosure information. He added the authority's board approves primary disclosure documents twice a year and that with every approval, the staff reminds board members of their responsibility to review the information.

Kathleen Marcus, also a shareholder with Stradling, noted the importance of written policies and procedures in connection with possible SEC enforcement actions, especially when an entity is seeking leniency.

"If you have policies in place, if you have designated people, you are going to be in a much better place if you get in the crosshairs of the SEC," she said.

Issuers also need to stay on top of material events, the panelists said. Torabi used one of his clients as an example of an effective way to do that, saying that it has designated a staff person to check every one of the ratings associated with their deals every other Monday to see if they have changed. He and other panelists highlighted the need for such a point person who can focus on material events disclosure.

Goldstein recommended that issuers also make use of outside compliance firms like Lumesis as a "second set of eyes."

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