

November 5, 2014

MEMORANDUM

TO: State Board of Regents

FROM: David L. Buhler

SUBJECT: Securities Exchange Commission (SEC) Municipalities Continuing Disclosure Cooperation (MCDC) Initiative

Issue

The SEC Division of Enforcement announced in March 2014 a voluntary self-reporting program for issuers and underwriters of bonds for a limited time and covering a limited topic. Essentially, the "MCDC Initiative" permits issuers, obligated persons, and underwriters to self-report misstatements concerning prior compliance with continuing disclosure obligations in an official statement for a municipal bond issue. In exchange, the SEC Division of Enforcement agrees to recommend "favorable" settlement terms for issuers and obligated persons, as well as for underwriters involved in the offering of those municipal securities (see the attached MCDC Initiative Settlement Terms document).

While the settlement terms for issuers involve cease-and-desist orders with specific required steps to be taken, for the most part they do not require monetary penalties. For underwriters, however, the terms are not as favorable and include monetary penalties that range from \$20,000 to \$60,000 per issue, with a maximum of \$500,000.

Background

The Securities and Exchange Commission's (SEC) Rule 15c2-12: Continuing Disclosure (see attached copy) requires the annual filing of financial and operating information pertaining to bonds issued in the form of a Continuing Disclosure Memorandum. This annual filing includes:

- Financial information and operating data provided by state or local government or other obligated persons
- Audited financial statements for state or local government or other obligated persons, if available
- Other relevant information specified in bonding documents, specifically the 'Continuing Disclosure Agreement'
- Notices of material events that modify the circumstances existing at the time the bonds were issued (see "Event Notices" in the attached SEC Rule 15c2-12: Continuing Disclosure document).

Because of information that has surfaced showing that, nationwide, significant numbers of issuers have been delinquent in filing complete information as required and underwriters that have failed to verify the

accuracy of issuers' continuing disclosure compliance reports, the SEC has implemented the MCDC Initiative that is focused on improving compliance with disclosure reporting on bonds issued since 2009.

OCHE Initiative

Even though it was our understanding that USHE institutions have been diligent in filing their required continuing disclosure reports, due to the high level visibility of this issue nationally and the potential negative consequences associated with non-compliance, we determined that it was in the best interest of USHE collectively to verify that required compliance reporting had been appropriately done. Also, in the event that statements in bond documents regarding an institution's continuing disclosure compliance were inaccurately reported, our goal was to evaluate each finding to enable institutions to review these events and file, if necessary, the required materials by the MCDC deadline. The initial filing deadline for both issuers and underwriters was initially September 10, 2014. The deadline for issuers only was subsequently delayed until December 1, 2014.

To accomplish the required review, we engaged Zions Bank, under the direction of Eric Pehrson, to conduct a review of the bonds issued on behalf of seven of the USHE institutions and to provide a report of findings to OCHE and the institutions. Mr. Kelly Murdock of RBC Capital Markets, who is the Financial Advisor for the University of Utah, is providing a similar review of relevant University of Utah bonds.

Findings

The results of their findings confirm that USHE institutions have been responsible in the requirements of continuing disclosure reporting. There were, however, some findings that relate to late filing of the required information, failure or late filing of changes in bond ratings (generally due to a downgrade of a bond insurer's rating), and failure to include some items specified in continuing disclosure agreements.

It is important to note that the stated focus of MCDC is not whether an issuer complied with its continuing disclosure filings, but rather addresses only *"possible violations involving materially inaccurate statements relating to prior compliance."* The *materiality* of disclosure failures falling into this category is being evaluated.

It is also noteworthy that the underwriters of all of the relevant bond issues were contacted to see if they had filed any MCDC self-reports of possible violations involving "materially inaccurate statements". Only one underwriter for a competitively bid bond issued by a USHE institution submitted a MCDC Initiative report. In that case, the institution had filed its operating and financial information 35 days late. The fact that none of the other underwriters filed is important information since the penalties imposed on underwriters, which include significant monetary penalties, are considerably more onerous than those for issuers.

Next Steps

We are in the process of completing and consolidating the collection of the relevant MCDC-related information. On October 10, 2014 a meeting was held with the people who researched the various institutions' disclosure compliance and with attorneys from Ballard Spahr and Chapman & Cutler, the firms that generally provide bond counsel for USHE bond issues, to review the findings and determine the next steps to finalize this issue. There was considerable discussion about the fact that the primary focus of the

MCDC Initiative is to clean up areas where continuing disclosure has been absent or woefully inadequate. The expectation is that SEC enforcement will focus on the more serious failures and misstatements and it does not appear that USHE institutions even remotely fall into that category.

It is, nevertheless, important to satisfactorily resolve these issues. Many issuers and their counsel have taken the approach of disclosing past missteps or failures in "Official Statements" without concluding or admitting that such failures were material in lieu of self-reporting them under the MCDC Initiative. This disclosure practice ensures that investors are informed, even in cases where the failures were almost certainly not material.

Since materiality is not a black and white issue and is determined on the basis of particular facts and circumstances in each instance, we have requested legal advice to determine if any of the findings requires filing under the MCDC Initiative. Most of those determined to not be material have already been disclosed using the "Official Statement" process described above. Timing is of the essence since December 1, 2014 is the filing deadline.

Going forward, we will be reviewing whether additional policies and procedures need to be adopted at the system and institutional levels in order to bolster the importance placed on ongoing institutional reporting responsibilities and whether or not a third-party should be contracted as a continuing disclosure reporting agent to assist in the disclosure reporting process.

Commissioner's Recommendation

This is an information item; no action is required.

David L. Buhler
Commissioner of Higher Education

DLB/GLS/WRH
Attachment



What is Continuing Disclosure?

Continuing disclosure consists of important information about a municipal bond that arises after the initial issuance of the bonds. This information generally reflects the financial health or operating condition of the state or local government as it changes over time, or the occurrence of specific events that can have an impact on key features of the bonds.

SEC Rule 15c2-12

Securities and Exchange Commission (SEC) Rule 15c2-12 requires dealers, when underwriting certain types of municipal securities, to ensure that the state or local government issuing the bonds enters into an agreement to provide certain information to the Municipal Securities Rulemaking Board about the securities on an ongoing basis. Such continuing disclosure agreements for new issues after December 2010 normally require the following:

Annual Financial Information

- Financial information and operating data provided by state or local government or other obligated persons
- Audited financial statements for state or local government or other obligated persons, if available

Event Notices

- Principal and interest payment delinquencies
- Non-payment related defaults
- Unscheduled draws on debt service reserves reflecting financial difficulties
- Unscheduled draws on credit enhancements reflecting financial difficulties
- Substitution of credit or liquidity providers, or their failure to perform
- Adverse tax opinions or events affecting the tax-exempt status of the security
- Modifications to rights of security holders
- Bond calls and tender offers
- Defeasances
- Release, substitution or sale of property securing repayment of the securities
- Rating changes
- Bankruptcy, insolvency or receivership

- Merger, acquisition or sale of all issuer assets
- Appointment of successor trustee

Timeframes for Submitting Disclosures

In most cases, state or local governments or obligated persons must submit annual disclosures on or before the date specified in the continuing disclosure agreement or provide notice of failure to do so to the MSRB through the Electronic Municipal Market Access (EMMA®) website at <http://emma.msrb.org>. Disclosure on events for new issues after December 2010 must be submitted to EMMA within 10 business days of the event.

Exemptions from Rule 15c2-12

Continuing disclosure generally is not required for an issue if:

- The entire issue is for less than \$1 million
- The bonds are sold to investors in units of no less than \$100,000 and are sold to no more than 35 sophisticated investors
- The bonds are sold in \$100,000 minimum denominations and mature in nine months or less from initial issuance
- The bonds were issued prior to July 1995 (or prior to December 1, 2010 for certain "puttable" securities.)

Locating Continuing Disclosure Information

The MSRB's EMMA® website publicly displays continuing disclosure information submitted since July 1, 2009, as part of the MSRB's mission to provide access to key municipal market information. The EMMA website also displays market transparency data and educational materials about the municipal securities market.

MCDC Initiative and Settlement Terms

(Excerpt from SEC Municipalities Continuing Disclosure Cooperation Initiative Release)

III. The MCDC Initiative

A. Who Should Consider Self-Reporting to the Division?

To be eligible for the MCDC Initiative, an issuer or underwriter must self-report by accurately completing the [attached questionnaire](#) and submitting it within the following applicable time periods:

- For underwriters, beginning March 10, 2014 and ending at 12:00 a.m. EST on September 10, 2014; and
- For issuers, beginning March 10, 2014 and ending at 5:00 p.m. EST on December 1, 2014.

Information required by the questionnaire includes:

- identification and contact information of the self-reporting entity;
- information regarding the municipal securities offerings containing the potentially inaccurate statements;
- identities of the lead underwriter, municipal advisor, bond counsel, underwriter's counsel and disclosure counsel, if any, and the primary contact person at each entity, for each such offering;
- any facts that the self-reporting entity would like to provide to assist the staff in understanding the circumstances that may have led to the potentially inaccurate statement(s); and
- a statement that the self-reporting entity intends to consent to the applicable settlement terms under the MCDC Initiative.

Submissions may be made by email to MCDCsubmissions@sec.gov, by fax to (301) 847-4713 or by mail to MCDC Initiative, U.S. Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, Boston, MA 02110.

C. Standardized Settlement Terms the Division Will Recommend

To the extent an entity meets the requirements of the MCDC Initiative and the Division decides to recommend enforcement action against the entity ("eligible issuer" or "eligible underwriter"), the Division will recommend that the Commission accept a settlement which includes the terms described below.⁵

1. *Types of Proceedings and Nature of Charges*

For eligible issuers, the Division will recommend that the Commission accept a settlement pursuant to which the issuer consents to the institution of a cease and desist proceeding under Section 8A of the Securities Act for violation(s) of Section 17(a)(2) of the Securities Act.⁶ The Division will recommend a settlement in which the issuer neither admits nor denies the findings of the Commission.

For eligible underwriters, the Division will recommend that the Commission accept a settlement pursuant to which the underwriter consents to the institution of a cease and desist proceeding under Section 8A of the Securities Act and administrative proceedings under Section 15(b) of the Exchange Act for violation(s) of Section 17(a)(2) of the Securities Act. The Division will recommend a settlement in which the underwriter neither admits nor denies the findings of the Commission.

2. *Undertakings*

For eligible issuers, the settlement to be recommended by the Division must include undertakings by the issuers. Specifically, as part of the settlement, the issuer must undertake to:

- establish appropriate policies and procedures and training regarding continuing disclosure obligations within 180 days of the institution of the proceedings;
- comply with existing continuing disclosure undertakings, including updating past delinquent filings within 180 days of the institution of the proceedings;
- cooperate with any subsequent investigation by the Division regarding the false statement(s), including the roles of individuals and/or other parties involved;
- disclose in a clear and conspicuous fashion the settlement terms in any final official statement for an offering by the issuer within five years of the date of institution of the proceedings; and
- provide the Commission staff with a compliance certification regarding the applicable undertakings by the issuer on the one year anniversary of the date of institution of the proceedings.

For eligible underwriters, the settlement to be recommended by the Division must include undertakings by the underwriters. Specifically, as part of the settlement, the underwriter must undertake to:

- retain an independent consultant, not unacceptable to the Commission staff, to conduct a compliance review and, within 180 days of the institution of proceedings, provide recommendations to the underwriter regarding the underwriter's municipal underwriting due diligence process and procedures;
- within 90 days of the independent consultant's recommendations, take reasonable steps to enact such recommendations; provided that the underwriter make seek approval from the Commission staff to not adopt recommendations that the underwriter can demonstrate to be unduly burdensome;
- cooperate with any subsequent investigation by the Division regarding the false statement(s), including the roles of individuals and/or other parties involved; and
- provide the Commission staff with a compliance certifications regarding the applicable undertakings by the Underwriter on the one year anniversary of the date of institution of the proceedings.

3. Civil Penalties

For eligible issuers, the Division will recommend that the Commission accept a settlement in which there is no payment of any civil penalty by the issuer.

For eligible underwriters, the Division will recommend that the Commission accept a settlement in which the underwriter consents to an order requiring payment of a civil penalty as described below:

- For offerings of \$30 million or less, the underwriter will be required to pay a civil penalty of \$20,000 per offering containing a materially false statement;
- For offerings of more than \$30 million, the underwriter will be required to pay a civil penalty of \$60,000 per offering containing a materially false statement;
- However, no underwriter will be required to pay a total amount of civil penalties under the MCDC Initiative greater than the following:
 - For an underwriter with total revenue over \$100 million as reported in the underwriter's Annual Audited Report – Form X-17A-5 Part III for the underwriter's fiscal year 2013: \$500,000;
 - For an underwriter with total revenue between \$20 million and \$100 million as reported in the underwriter's Annual Audited Report – Form X-17A-5 Part III for the underwriter's fiscal year 2013: \$250,000; and
 - For an underwriter with total revenue below \$20 million as reported in the underwriter's Annual Audited Report – Form X-17A-5 Part III for the underwriter's fiscal year 2013: \$100,000.