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# South Carolina GFOA Conference

## Post Issuance Compliance - After the MCDC Initiative



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# Learning Objectives

- Understanding what you are committing to do for the life of your issue
- Detailing the substantive content of continuing disclosure
- Outlining the mechanics of disclosing
- Addressing the legal risks uncovered by MCDC

# Why Disclose?

- **Practical reasons:**
  - Buyers won't buy unless buyers know what they're buying
    - Buyers can't kick the tires, they buy on the specs
    - Buyers aren't buying an object, but a promise of performance over time
    - Buyer interest/trust needed to allow issuer to sell the new issue & to maintain secondary market liquidity for the life of the issue
  - Issuers/obligors want to raise capital at lowest possible cost
    - Buyers will pay up for attractive product specs & gilt-edged promises of performance – lower interest payments
    - Buyers will demand better pricing for product specs &/or promises of performance that expose buyers to increased risks – higher interest payments
    - New issue buyers will demand better pricing if secondary market liquidity may be weak – higher interest payments

# Why Disclose?

- Legal/regulatory reasons:
  - Issuer/obligor can't reach broad market without disclosure
    - SEC Rule 15c2-12 prohibits broker-dealers from underwriting most public offerings without:
      - delivery of issuer/obligor primary market disclosure (Official Statement – **OS**)
      - promise of issuer/obligor on-going disclosure (Continuing Disclosure Agreement -- **CDA**)
  - Issuer/obligor must comply with anti-fraud laws
    - Once issuer/obligor decides to disclose something about product specs & promise of performance, that disclosure must:
      - not include untrue statement of material fact
      - not omit material fact necessary to make statements made, in light of circumstances under which made, not misleading



# Why Disclose?

- **Contractual/regulatory reasons:**
  - Issuer/obligor needs to comply with contractual obligation
    - CDA creates contractual obligation to carry out promise of on-going disclosure for years after initial issue
  - Issuer/obligor must disclose their material failures to comply
    - If issuer/obligor has new public offering, will need to disclose prior material continuing disclosure failures in OS in order to:
      - allow underwriting of new offering under Rule 15c2-12
      - Ensure that issuer/obligor statements in OS do not violate Federal anti-fraud laws
  - Non-disclosure of CDA compliance failure in OS, not compliance failure itself, was at heart of SEC's MCDC enforcement initiative

# What to Disclose?

- **Establishing the continuing disclosure obligation**
  - On-going issuer/obligor continuing disclosure commitment is set at time of new issue
  - OS disclosures must include:
    - Terms of the new issue, describing the features of the securities and the terms on which they are purchased and repaid
    - Financial information and operating data of issuer/obligor, where material to evaluating the new issue
    - Description of CDA and of instances of material failures to comply with prior CDAs during previous 5 years
  - OS new issue financial/operating disclosures create baseline obligation for annual financial disclosures under CDA

# What to Disclose?

- **Establishing the continuing disclosure obligation**
  - CDA must include commitment to disclose:
    - Annually, updated financial/operating data for issuer/obligor of the type included in the OS (“**annual financial information**”)
    - Annually, audited financial statements of issuer/obligor, if prepared, whether or not included in OS
    - When applicable, notices of specified events occurring throughout life of issue
  - CDA must specify:
    - Which issuer/obligor must make disclosures
    - Specify what annual financial information is to be provided
    - Specify date by which annual financial information is to be provided
    - Require submission of disclosures, properly indexed, to EMMA system (<http://emma.msrb.org>)

# What to Disclose?

- **Assigning responsibility for disclosure**
  - If there are multiple issuers/obligors, be clear about who provides each portion of annual financial information
    - Do not leave any gaps of responsibility – that is, make sure that each part of the annual financial information will be addressed in the future
    - Do not create ambiguous or overlapping responsibility – that is, do not create situation where more than one party may feel responsible for a particular part of the annual financial information
    - Make sure the right party is responsible for information that it can produce or access on its own in the future
  - Clarity ensures effective disclosure, and also allows each issuer/obligor to provide accurate disclosure of its own past continuing disclosure performance in a subsequent new issue

# What to Disclose?

- Setting clear deadlines
  - Be clear in CDA about deadlines for submitting annual financial information
    - While in the past imprecise deadlines might have been viewed as providing some flexibility on timing of annual disclosures, post-MCDC creates a premium on precise understanding of deadline
    - Days = days & months = months; 180 days does not equal 6 months
    - If different portions of annual financial information have different deadlines, make clear which deadline applies to which portion

# What to Disclose?

- **Annual financial information vs. audited financial statements**
  - Be clear on whether audited financial statements due at same time as, or different time from, annual financial information
    - Are audited financial statements part of, or separate from, annual financial information?
      - If the OS included audited financial statements, SEC likely would expect that “annual financial information” would include the audited financial statements
      - If you want a separate deadline for the audit, state that clearly and unambiguously in your CDA
      - Many older CDAs have explicit or implicit inconsistencies as to whether audited financial statements are part of annual financial information and whether there is a separate deadline

# Annual Financial Information – A Closer Look

- Annual financial information to be include in CDA under Rule 15c2-12 consists of:
  - *financial information or operating data* that is . . .
  - . . . *of the type* included in the Official Statement
- While financial/operating data included in OS is baseline scope of annual financial information, annual financial information **not** required by Rule to be identical to OS's financial/operating data

# Annual Financial Information – A Closer Look

- Scope of annual financial information defined in CDA, which must specify:
  - in *reasonable detail* . . .
  - . . . *the type of* financial information and operating data to be provided as part of annual financial information
- Thus, Rule 15c2-12 allows flexibility in connection with annual financial information in that:
  - only the “type” of information, not the precise content and manner of presentation, need be specified, and
  - such type need only be specified in “reasonable detail,” not with precise details of all aspects of the information



# Annual Financial Information – A Closer Look

- SEC staff has clarified:
  - operating data is quantitative & limited to issuer/obligor's operations – excludes textual descriptions, demographic data, forecasts
  - sufficient to specify general categories of information
    - SEC specifically embraced use of general categories as way to avoid need for amendments to CDAs as circumstances change
    - if required information no longer can be generated because operations have changed, statement to that effect sufficient
      - providing similar data on substitute operations is good practice
- What seems like relevant & available information today may be irrelevant or unavailable over life of an issue

# Audited Financial Statements – A Closer Look

- The SEC has stated that:
  - *“The same financial statements that are included in the final official statement must be provided as part of the annual financial information.”*
  - Thus, if the OS included the audited financial statements, the SEC expects the audited financial statements to be part of the annual financial information
- If intend to have separate deadline for audited financial statements from remainder of annual financial information, CDA must clearly differentiate the audit from such other information

# Audited Financial Statements – A Closer Look

- Rule 15c2-12 and subsequent SEC interpretations acknowledge that audited financial statements may sometimes be delayed beyond CDA deadlines
- The SEC has stated that:
  - *“If audited financial statements are not available by the time the annual financial information must be provided, unaudited financial statements must be provided as part of the annual financial information, and, as required by the rule, audited financial statements, when and if available, must be provided ....”*

# Audited Financial Statements – A Closer Look

- If CDA includes audited financial statements in annual financial information, or ...
- ... if CDA establishes a separate specific deadline for audited financial statements, ...
- ... in either case, issuer/obligor should provide unaudited financial statements if audited financial statements are not available by applicable deadline, ...
- ... even if CDA does not explicitly require that issuer/obligor provide unaudited financial statements

# Audited Financial Statements – A Closer Look

- Many CDAs state that audited financial statements will be provided when and if available
  - The SEC has not provided guidance on:
    - At what point audited financial statements are considered to be “available” for purposes of Rule 15c2-12
    - How much time between such availability and the posting of audited financial statements on EMMA is consistent with the Rule
    - SEC may be tempted to use the date of the auditor’s letter as a consistent proxy, and it is unclear how the SEC would treat any issuer/obligor acceptance/review/approval process

# Notice Requirements – Event Notices – A Closer Look

- Rule 15c2-12 requires notices upon occurrence of 14 specifically identified events with respect to an issue
  - For some events, notice is only required if material (*e.g.*, default not related to payment, bond call, etc.)
  - For most events, notice is required regardless of materiality (*e.g.*, payment default, defeasance, etc.)
  - Notice required within 10 business days of occurrence, not upon issuer/obligor gaining knowledge of event
  - Many triggering events are discoverable only by issuer/obligor or certain closely-involved third-parties

# Notice Requirements – Failure to File – A Closer Look

- Rule 15c2-12 requires timely notice if issuer/obligor fails to provide annual financial information by deadline
  - If failure consists of audited financial statements not being available by deadline, MSRB has provided “suggested practice” indicating that no failure to file notice required if:
    - unaudited financial statements are provided by the deadline and
    - such unaudited financial statements are accompanied by a disclosure that audited financial statements will be submitted when available
- Rule does not require failure to file notice for failed or late event notices or voluntary disclosures under a CDA

# CDA Drafting Considerations

- CDA language is important – don't settle for boilerplate, cut & paste, or last minute scrambled drafting
- CDA should fully leverage flexibility permitted by SEC:
  - describe annual financial information by type
    - *e.g.*, if OS provides data in table form, describe type of data in table rather than promising to reproduce the table itself – such as:
      - ***“the Annual Report shall include updated information of the type included in Tables 2 through 7 in Appendix A”***
    - rather than
      - ***“the Annual Report shall include updated Tables 2 through 7 as set forth in Appendix A”***
    - you can continue using identical updated tables as long as you choose
    - but provides flexibility to modify presentation & reorganize data in most meaningful manner as of time of future disclosures



# CDA Drafting Considerations

- Consider including language anticipating potential changes in availability or relevance of data over life of issue – such as clauses to effect that:
  - if information to be included in annual financial information can no longer be generated because operations have changed or information is otherwise no longer available, annual financial information may include a statement to that effect in lieu of such information
  - if such information is omitted, issuer may wish to provide reasonably comparable information, to the extent available, from substitute operations or otherwise, together with a comparison between new and original information

# CDA Drafting Considerations

- CDA for one issue does not exist in isolation from CDAs for other issues
  - Shorter deadline in one CDA effectively shortens deadline for all CDAs for the same credit
  - Differing elements of annual financial information from one CDA to the next effectively causes the total annual financial information for all CDAs to grow to encompass all data elements

# Achieving Compliant Continuing Disclosure

- Important that CDA is drafted to be in compliance with requirements of Rule 15c2-12
- However, if terms of CDA diverge from Rule requirements, issuer/obligor disclosure compliance is tested against terms of CDA, not the Rule ...
- ... and OS disclosure about past disclosure compliance is tested against terms of CDA, not the Rule ...
- ... subject to compliance guidance from the regulators.
  - But statements of policy positions, best practices or compliance guidance by trade associations or others cannot serve to modify CDA terms with which issuer/obligor must comply

# Achieving Compliant Continuing Disclosure – Annual Financial Information/Audit

- Know your deadlines and know which issuer/obligor is assigned to provide each item of required information
- Use internal or third-party templates to create each annual financial information filing
- Create standing disclosure team with right personnel to provide each item of information
  - Team that prepared OS financial/operating disclosures also needed to prepare annual financial information filing
  - Provide team with in-house or third party disclosure training
- Leverage in-house or third party reminder services

# Achieving Compliant Continuing Disclosure – Required Notices

- Know when failure to file notices required or not required, recognize when they are triggered & consider leveraging third-party automatic notice generation
- Understand which personnel best positioned to recognize when each type of event notice is triggered
- Establish protocol to ensure such personnel can effectively route such information to disclosure team
- Appoint event notice lead in disclosure team to confirm whether event notice required (*e.g.*, is event a covered event & is materiality a factor?)

# Achieving Compliant Continuing Disclosure – Other Considerations

- Know your issues and your CUSIP numbers ...
  - ... but don't worry about extra CUSIPs with unusual names (*e.g.*, ROCS, ROLS, etc.) associated with your bonds on EMMA – they are artifacts and don't require disclosures
- Feel free to submit voluntary disclosures ...
  - ... but “voluntary” disclosures required by your CDA count when testing CDA compliance
- Create, implement & enforce policies & procedures to achieve compliance ...
  - ... they will be required if you participate in MCDC, and they are a good idea in any event

# MCDC

- MCDC = Municipalities Continuing Disclosure Cooperation Initiative
  - SEC voluntary market-wide settlement offer on favorable terms to:
    - Issuers/obligors for materially inaccurate statements in OSs about past compliance with CDAs
    - Underwriters for failure to conduct adequate due diligence regarding issuer/obligor disclosures of past compliance with CDAs
  - SEC has completed the underwriter phase of MCDC
    - 72 underwriters effectively comprising the entire municipal market underwriting community have settled
    - Underwriters paid reduced fines & agreed to have consultants review and recommend changes to their due diligence policies & procedures

# MCDC

- MCDC = Municipalities Continuing Disclosure Cooperation Initiative
  - SEC is beginning issuer/obligor phase of MCDC
    - Currently reaching out to some issuers/obligors that chose to report potential violations to review settlement terms & confirm participation
    - Number of issuers/obligors participating in MCDC is currently unknown
    - Issuers/obligors to pay no fines & must agree to establish policies and procedures, and training, for continuing disclosure obligations



# The MCDC Legacy on Continuing Disclosure Practices

- MCDC = Municipalities Continuing Disclosure Cooperation Initiative
  - SEC tolerance for disclosure non-compliance will be sharply reduced in wake of MCDC
  - SEC likely to take issue with any issuer/obligor with policies & procedures required by an MCDC settlement but which falls out of compliance with such policies & procedures
  - SEC will likely seek fines for issuers/obligors not participating in MCDC that have misstated CDA compliance
  - SEC also may seek enforcement against individuals causing violations
- MCDC has raised the stakes on CDA compliance

# Questions & Answers

- Any Questions??



## **Lisa Olsen, Senior Vice President – [lolsen@dacbond.com](mailto:lolsen@dacbond.com)**

Lisa has been a Senior Vice President of DAC since its inception in 2000. Lisa has extensive experience in compliance reporting and investor relations services to hundreds of state and local governments, housing, healthcare and other issuers of municipal bonds throughout the country and abroad.

During Lisa's 25 years' experience in the municipal bond industry, she participated in all types of municipal bond financings. Lisa's primary duties involve marketing DAC services to issuers. Lisa works collaboratively with DAC's client service and the support departments in managing all client relationships.

Lisa was a participant in initial discussions with the Securities and Exchange Commission and worked closely with DAC's Chief Executive Officer and outside Counsel to develop DAC's Disclosure Dissemination Agent Agreement conforming to SEC Rule 15c2-12 and recently participated in DAC's review of over 22,000 bond issues under the SEC's MCDC Initiative.

Lisa is frequently invited to speak before groups interested in learning about compliance and investor related outreach programs and has authored several articles published in municipal finance related periodicals. Lisa is a member of Florida Government Finance Officers Association, National Federation of Municipal Analysts, Southern Municipal Analyst Society, the Healthcare Financial Management Association, and holds memberships in other bond related organizations. She received a Bachelor of Science degree from Christian Brothers University majoring in Marketing and Management.

Lisa was recognized by Smith's Research and Ratings for her life-long dedication and leadership in helping establish "best practice" disclosure guidelines for the municipal marketplace.