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PRESENTATION FOR THE CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION (CDIAC) SEMINAR

MUNICIPAL MARKET DISCLOSURE: THE DEVELOPMENT AND ADMINISTRATION OF DEBT DISCLOSURE POLICIES

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SAN MATEO, CALIFORNIA

INTRODUCTION

Elaine C. Greenberg, a partner in the Washington, D.C., office of Orrick, Herrington & Sutcliffe LLP, is a member of the firm's Securities Litigation, Investigations and Enforcement Group. Ms. Greenberg's practice focuses on securities and regulatory investigations and enforcement actions, securities litigation, public finance, and white collar and corporate investigations. She has represented underwriters, broker-dealers, issuers, municipal advisors, former public company officers, and others. Ms. Greenberg has more than 28 years of securities law experience and possesses deep institutional knowledge of SEC policies, practices, and procedures. As a Senior Officer in the SEC's Enforcement Division, she served in dual roles as Associate Director for the Philadelphia Regional Office where she oversaw the SEC's enforcement program for the Mid-Atlantic region, and as the first National Chief of the Specialized Unit for Municipal Securities and Public Pensions, where she was responsible for building and maintaining a nation-wide unit, and oversaw the SEC's enforcement efforts in the U.S.'s municipal securities and public pension marketplaces.

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WHY ARE DISCLOSURE POLICIES IMPORTANT?

PLACING DISCLOSURE POLICIES WITHIN THE CONTEXT OF TRENDS IN SEC ENFORCEMENT ACTIVITY

SEC Perspective and Trends

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- Comprehensive July 2012 SEC Report on Municipal Securities Market Highlights Lack of Transparency in the Market
- Concern that Investors Will Be Harmed if Market is Left Unchecked
- Increased Scrutiny of Municipal Securities
- Considers Conduct of All Market Participants Involved in Offering or Transaction, including Issuers, Public Officials, Underwriters, Broker-Dealers, Municipal Advisors, and others

SEC Perspective and Trends

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- Emphasis on Issuer Disclosures in Primary and Secondary Markets
- Scrutiny of Underwriter Due Diligence Practices
- Focus on Liability and Accountability of Individuals
- Increased number of enforcement actions
- Aggressive use of legal theories and remedies against issuers, public officials, underwriters and broker-dealers
- Novel Initiatives such as Municipalities Continuing Disclosure Cooperation (“MCDC”)

Federal Securities Law Requirements

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- Municipal securities are generally exempt from the SEC's registration and reporting requirements.
- However, they are not exempt from the antifraud provisions of the federal securities laws.
- Therefore, municipal securities issuers, underwriters, and others can be liable for violations of those statutes.
- Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder make it unlawful, in connection with the offer, purchase, or sale of securities, to:

Federal Securities Law Requirements

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- employ any device, scheme, or artifice to defraud
- make any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading
- engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any person

Federal Securities Law Requirements

"Materiality" standard for misrepresentations and omissions:

- No definition of "material" in any SEC statute or rule
- No bright-line test
- Determinations are made on a case-by-case basis, in the context of all of the facts and circumstances
- Look to case law and SEC enforcement actions for guidance
- U.S. Supreme Court case of Basic Inc. v. Levinson (1988):

  Whether there is a "substantial likelihood that a reasonable investor would consider the information important in deciding whether or not to invest"

  Whether there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available"

Federal Securities Law Requirements

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Different Standards of Liability

- Section 10(b) and Rule 10b-5 under the Exchange Act: Violation must be based upon an intent to defraud (can be actual intent or recklessness)

- Sections 17(a)(2) and (3) of the Securities Act: Violation can be based upon negligence

Federal Securities Law Requirements

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- Rule 15c2-12 under the Exchange Act indirectly regulates municipal securities offerings by directly regulating the actions of underwriters.

- The Rule requires an underwriter, prior to bidding for, purchasing, or selling a primary offering of municipal securities, to:

    - obtain and review a “deemed final” official statement

    - reasonably determine that an issuer, or obligated person, has undertaken in a written agreement or contract for the benefit of holders of the securities, to provide the MSRB with certain specified continuing disclosures, including annual financial information, and notices of certain events

Federal Securities Law Requirements

Those events include:
principal and interest payment delinquencies;
non-payment related defaults, if material;
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, Internal Revenue Service (IRS) notices or events affecting the tax status of the security;
modifications to rights of security holders, if material;
bond calls, if material;
tender offers;
defeasances;
release, substitution, or sale of property securing repayment of the securities, if material;
rating changes;
bankruptcy, insolvency, receivership or similar event;
merger, consolidation, or acquisition, if material;
appointment of a successor or additional trustee, or the change of name of a trustee, if material; and
notices of failures to provide annual financial information on or before the date specified in the written agreement.

Federal Securities Law Requirements

- Notices of these events must be made in a timely manner not in excess of ten business days after the occurrence of the event

- Rule 15c2-12(f)(3) also states that the final official statement has to set forth:

- a description of the continuing disclosure undertakings

- A description of any instances in the previous five years in which the issuer failed to comply, in all material respects, with any previous continuing disclosure undertaking

Federal Securities Law Requirements

- At the time the SEC first released a draft of proposed Rule 15c2-12 in 1988 and with each amendment thereafter, the SEC has emphasized the duties of underwriters in connection with the entire official statement, not only the section about continuing disclosure.

- In its Release adopting the 2010 amendments to the Rule, the SEC repeated its views that underwriters have a duty under the antifraud provisions of the federal securities laws, in both negotiated and competitively bid municipal securities offerings, to have a reasonable basis for recommending any municipal securities and in fulfilling that responsibility, to:

Federal Securities Law Requirements

- review the issuer's or obligated person's disclosures in a professional manner with respect to accuracy and completeness of statements made and
- to have a reasonable basis for belief in the truthfulness and completeness of the key representations in the disclosure documents, including the likelihood that an issuer or obligated person will comply on a timely basis with its disclosure undertakings
- Forming that "reasonable basis" is what is typically referred to as "due diligence"

Federal Securities Law Requirements

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- In its March 2012 National Examination Risk Alert, the SEC reiterated its views on a municipal underwriter's due diligence obligation:

  "By participating in an offering, an underwriter makes an implied recommendation about the securities it is underwriting. By holding itself out as a securities professional and, especially in light of its relationship with the issuer, a municipal underwriter also makes a representation that it has a reasonable belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offering. Thus, if the broker-dealer fails to undertake efforts to form such a reasonable belief, it may violate the antifraud provisions of the securities laws."

SEC Enforcement Activity and Lessons Learned

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- The SEC has been steadily increasing its enforcement activity in the municipal securities area.
- A core mission of the SEC is investor protection. In the SEC's view, proper disclosure allows investors to understand and evaluate the financial risk of the security in which they are investing.
- Most of the SEC's enforcement actions have involved material misrepresentations and omissions in connection with disclosures to investors.
- The SEC has pursued numerous enforcement actions against issuers, underwriters and others where it found that the root of the problematic conduct stemmed from poor or non-existent disclosure policies, procedures and training.
- Therefore, the lack of, or inadequate, policies, procedures, and training can contribute to or result in violations of the antifraud provisions of the federal securities laws.
- The following cases illustrate why written policies and procedures as well as training are important in facilitating compliance with disclosure obligations under the federal securities laws and what can go wrong if they are not established.
- As these cases demonstrate, if written policies, procedures and training are not already in place, the SEC will require them to be developed and implemented as a condition of settlement.

SEC Enforcement Activity and Lessons Learned

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City of San Diego (11/14/06)

- Settled enforcement action against the City for false and misleading statements in five bond offerings between 2002 –2003 totaling $260 million regarding the City's looming pension fund crisis.
- SEC found that City committed securities fraud by failing to disclose important information about its pension and retiree healthcare obligations and its disclosures about these obligations and its ability to pay those obligations were misleading.
- The City failed to disclose that its unfunded liability to its pension plan was projected to dramatically increase, growing from $284 million at the beginning of fiscal year 2002 to an estimated $2 billion by 2009, and that the City's liability for retiree health care was another estimated $1.1 billion.

SEC Enforcement Activity and Lessons Learned

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- The City also failed to disclose that it had been intentionally under-funding its pension obligations so that it could increase pension benefits but defer the costs, and that it would face severe difficulty funding its future pension and retiree health care obligations unless new revenues were obtained, pension and health care benefits were reduced, or city services were cut.

- The SEC further found that the City made these misleading statements through three different means. First, the City made misleading statements in the official statements and preliminary official statements for five bond offerings. Second, the City made misleading statements to the agencies that gave the City its credit rating for its municipal bonds. Third, the City made misleading statements in its "continuing disclosure statements," which described the City's financial condition and were provided by the City to the municipal securities market with respect to prior City bond offerings.

- The City's enormous pension and retiree health liabilities and its failure to disclose those liabilities placed the City in serious financial straits.

SEC Enforcement Activity and Lessons Learned

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- The SEC's Order stated that since 2005, the City implemented several remedial measures with a view to detect and prevent securities violations. These included:
- Hiring a full time municipal securities attorney who is responsible for coordinating the City's public disclosure and who has conducted continuing education for the City's deputy attorneys on the City's disclosure requirements.
- Hiring new disclosure counsel for all of its future offerings, who will have better and more continuous knowledge on the City's financial affairs. This disclosure counsel has conducted seminars for City employees on their responsibilities under the federal securities laws.
- Enacting ordinances designed to change the City's disclosure environment. First, the City created a Disclosure Practices Working Group, comprised of senior City officials from across city government. The Working Group is charged with reviewing the form and content of all the City's documents and materials prepared, issued, or distributed in connection with the City's disclosure obligations relating to securities issued by the City or its related entities; and conducting a full review of the City's disclosure practices and to recommend future controls and procedures. Second, the Mayor and City Attorney must now personally certify to the City Council the accuracy of the City's official statements. Third, the City Auditor must annually evaluate the City's internal financial controls and report the results to the City Council.

SEC Enforcement Activity and Lessons Learned

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- The SEC's Order also included undertakings with which the City was required to comply. These included retaining an Independent Consultant to:
- (a) conduct annual reviews for a three-year period of the City's policies, procedures, and internal controls regarding its disclosures for offerings, including disclosures made in its financial statements, pursuant to continuing disclosure agreements, and to rating agencies, the hiring of internal personnel and external experts for disclosure functions, and the implementation of active and ongoing training programs to educate appropriate City employees, including officials from the City Auditor and Comptroller's office, the City Attorney's office, the Mayor, and the City Council members regarding compliance with disclosure obligations;
- (b) make recommendations concerning these policies, procedures, and internal controls with a view to assuring compliance with the City's disclosure obligations under the federal securities laws; and
- (c) assess, in years two and three, whether the City is complying with its policies, procedures, and internal controls, whether the City has adopted any of the Independent Consultant's recommendations from prior year(s) concerning such policies, procedures, and internal controls for disclosures for offerings, and whether the new policies, procedures, and internal controls were effective in achieving their stated purposes.

SEC Enforcement Activity and Lessons Learned

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- Subsequent to the SEC's action against the City of San Diego, the SEC charged the City's outside auditor and various former City officials.
- On 12/11/07, Linda Thomsen, Director of the SEC's Division of Enforcement gave a speech entitled "Lessons Learned from San Diego."
- Among other things, she stated that critical lessons for municipal securities issuers include:
- Consider whether your internal controls and systems produce financial reports and disclosure documents that are accurate and complete. Written policies and procedures should, at a minimum: clearly identify who is responsible for what; clearly state the process by which the disclosure is drafted and reviewed; and provide checks and balances so there is adequate supervision and reasonable disbursement of responsibilities so that too much power and information is not placed with just one person.
- Provide training to your officials and employees regarding the applicable disclosure requirements of the federal securities laws. Training should include practical training on the disclosure and financial reporting requirements of the federal securities laws; specific training on the particular person's role and responsibilities in the disclosure and financial reporting process; and training for everyone involved in the disclosure process-from the city council members to the staff members who are involved in the initial drafting of the disclosure documents.

SEC Enforcement Activity and Lessons Learned

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State of New Jersey (8/18/10)

- Settled action against the State of New Jersey, charging it with securities fraud for misrepresenting and failing to disclose to investors in billions of dollars worth of municipal bond offerings that it was underfunding the state's two largest pension plans.
- New Jersey was the first state ever charged by the SEC for violations of the federal securities laws.
- According to the SEC's order, New Jersey offered and sold more than $26 billion worth of municipal bonds in 79 offerings between August 2001 and April 2007. The offering documents for these securities created the false impression that the Teachers' Pension and Annuity Fund (TPAF) and the Public Employees' Retirement System (PERS) were being adequately funded, masking the fact that New Jersey was unable to make contributions to TPAF and PERS without raising taxes, cutting other services or otherwise affecting its budget.
- As a result, investors were not provided adequate information to evaluate the state's ability to fund the pensions or assess their impact on the state's financial condition.

SEC Enforcement Activity and Lessons Learned

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- The SEC's order found that New Jersey made material misrepresentations and omissions about the underfunding of TPAF and PERS in bond disclosure documents that included preliminary official statements and official statements, and continuing disclosures including Treasurer’s Annual Reports.
- The State did not adequately disclose that it was under funding TPAF and PERS, why it was under funding TPAF and PERS, or the potential effects of the under funding.
- Furthermore, the State had no written policies or procedures relating to the review or update of bond offering documents and the State did not provide training to its employees concerning the State's disclosure obligations under accounting standards or the federal securities laws.
- Accordingly, the State’s procedures were inadequate for ensuring that material information concerning TPAF and PERS or the State’s financing of TPAF and PERS was disclosed and accurate in bond offering documents.
- Due to this lack of disclosure training and inadequate procedures for the drafting and review of bond disclosure documents, the State made material misrepresentations to investors and failed to disclose material information regarding TPAF and PERS in bond offering documents.

SEC Enforcement Activity and Lessons Learned

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- In determining to accept New Jersey's Offer of Settlement, the SEC's Order stated that it considered the remedial acts taken by the State which included:
- Enhancing its pension funding disclosures by hiring disclosure counsel to advise the State on an on-going basis regarding its disclosure obligations under the federal securities laws.
- With the assistance of disclosure counsel, reviewing, evaluating, and enhancing its disclosure process by instituting formal, written policies and procedures. In its written policies and procedures, among other things, the State established a committee comprised of senior Treasury officials, representatives from the Attorney General's Office, and disclosure counsel to oversee the entire disclosure process and to review and make recommendations regarding the State's disclosures and disclosure practices.
- In addition, the State implemented an annual mandatory training program conducted by disclosure counsel for the State's employees involved in the disclosure process to ensure compliance with the State's disclosure obligations under the federal securities laws.

SEC Enforcement Activity and Lessons Learned

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State of Illinois (3/11/13)

- Settled action against the State of Illinois finding that in connection with multiple bond offerings raising over $2.2 billion from approximately 2005 through early 2009, the State misled bond investors about the adequacy of its statutory plan to fund its pension obligations and the risks created by the State's underfunding of its pension systems.
- The State omitted to disclose in preliminary and final official statements material information regarding the structural underfunding of its pension systems and the resulting risks to the State's financial condition.
- The State's misleading disclosures resulted from, among other things, various institutional failures. The State failed to adopt or implement sufficient controls, policies, or procedures designed to ensure that material information was assembled and communicated to individuals responsible for disclosure determinations, to train personnel involved in the disclosure process adequately, or to retain disclosure counsel. As a result, the State lacked proper mechanisms to identify and incorporate into its official statements relevant information held by the pension systems and other bodies within the State.

SEC Enforcement Activity and Lessons Learned

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- The State failed to implement sufficient policies and procedures, to conduct adequate training, or to consult securities disclosure counsel to ensure adequate disclosure. Relying on prior “carryover” disclosures and “page-turn” reviews during group conference calls, the State and its advisors did not scrutinize the institutionalized description of the Plan adequately and made little affirmative effort to collect potentially pertinent information from knowledgeable sources.
- The result was a process in which no one person fully accepted responsibility for identifying and analyzing potential pension disclosures.

SEC Enforcement Activity and Lessons Learned

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- In determining to accept Illinois' Offer, the SEC considered remedial acts undertaken by the State, which included taking significant steps to correct the process deficiencies and enhance its pension disclosures.

- Among other things, the State retained disclosure counsel, significantly enhanced disclosures in the pension section of its bond offering documents, instituted written policies and procedures, developed training programs and materials, and added formal disclosure controls regarding pension disclosures.

- The State also designated a disclosure committee responsible for collecting information from relevant sources, evaluating the State's disclosure obligations, and approving bond offering disclosures. Prior to dissemination of official statements, the committee ensures that the disclosures are reviewed by the pension systems, the State's Commission on Government Forecasting and Accountability, the Office of the Comptroller, the Office of the Treasurer, and the Office of the Illinois Attorney General.

SEC Enforcement Activity and Lessons Learned

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State of Kansas (8/11/14)

- Settled action against State of Kansas finding that it failed to disclose that the state's pension system was significantly underfunded, which created a repayment risk for investors.
- According to the SEC's Order, from August 2009 through July 2010, the Kansas Development Finance Authority ("KDFA") raised $273 million through eight series of bonds on behalf of the state and its agencies without disclosing in the bond offering documents that the Kansas Public Employees Retirement System ("KPERS") was the second-most underfunded state pension system in the country.
- The SEC found that the underfunding was a material fact that was required to be disclosed in Kansas's offering documents.
- The failure to disclose this material information in the Official Statements resulted from insufficient procedures and poor communications between KDFA and the Kansas Department of Administration ("KDA"), which provided information to KDFA for inclusion in the Official Statements, including preparing the State's financial statements that were included as part of the Official Statement.

SEC Enforcement Activity and Lessons Learned

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- Although KDFA, KDA, and other members of the working group had an informal process for the development and review of official statements, neither KDFA nor KDA had any formal written policies or procedures for addressing trends or risk factors that might be material to bondholders.
- KDFA operated with the understanding that KDA was responsible for providing the information and disclosures in the Official Statements relating to financial issues impacting the State. Conversely, KDA understood that KDFA was responsible for such disclosure.
- This lack of clear communication, together with the absence of effective written policies or procedures in either organization, meant that neither KDA nor KDFA identified the absence of the KPERS unfunded liability, or discussed the need to add such disclosure to the Official Statements.
- In accepting Kansas' Offer of Settlement, the SEC considered remedial acts undertaken by the State, which included adopting new disclosure policies and procedures which, among other things, designated responsible parties in critical State agencies, mandated closer communication and cooperation among those agencies, established a State Disclosure Committee, and required annual training of key personnel.

SEC Enforcement Activity and Lessons Learned

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City of Harrisburg (5/6/13)

- Settled enforcement action in which the SEC charged the City with securities fraud for its misleading public statements when its financial condition was deteriorating and financial information available to municipal bond investors was either incomplete or outdated.
- SEC found that the misleading statements were made in the City's budget report, annual and mid-year financial statements, and a State of the City address.
- Case marked the first time that the SEC charged a municipality for misleading statements made outside of its securities disclosure documents.
- SEC found that the City failed to comply with its undertakings in Continuing Disclosure Certificates to provide ongoing financial information and audited financial statements for the benefit of investors holding hundreds of millions of dollars in bonds issued or guaranteed by the City.
- As a result, investors had to seek out Harrisburg's other public statements in order to obtain current information about its finance.

SEC Enforcement Activity and Lessons Learned

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- Simultaneously with its enforcement action, the SEC issued a separate report under Section 21(a) of the Exchange Act to address the disclosure obligations of public officials and their potential liability under the federal securities laws for public statements made in the secondary market for municipal securities.
- 21(a) Report states that public officials should be mindful that their written or oral public statements may affect the total mix of information available to investors and could result in antifraud liability if such statements are materially misleading or omit material information. Report further states that public officials should consider taking steps to reduce the risk of misleading investors.
- Report states that, at a minimum, public officials should consider:
- Adopting policies and procedures that are reasonably designed to result in accurate, timely, and complete public disclosures;
- Identifying those persons involved in the disclosure process;
- Evaluating other public disclosures including financial information made by the municipal issuer; and
- Assuring that responsible individuals receive training about their obligations under the federal securities laws.

SEC Enforcement Activity and Lessons Learned

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City of South Miami (5/22/13)

- Settled enforcement action charging the City with defrauding investors about the tax-exempt financing eligibility of a mixed-use retail and public parking structure.
- SEC's Order states that the City failed to disclose that it jeopardized the tax-exempt status of two bond offerings by impermissibly loaning proceed from the first offering to a private developer and restructuring a lease agreement prior to the second offering.
- The Order states that the City's Finance Department experienced significant turnover from 2005 through 2009. The annual certifications required as part of the financing were signed by at least four different finance directors who were unaware of the implications of the certifications and how the 2005 Lease and Developer Loan affected the tax status of the bonds.

SEC Enforcement Activity and Lessons Learned

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- The Order further states that the City's finance directors, while responsible for receiving, signing, and returning the annual compliance certifications, had no previous experience completing, reviewing, or assessing disclosure requirements or tax issues in bond offerings and did not receive any training or guidance on the subject.

- In August 2011, the City entered into agreements with the IRS by paying it $260,345 and defeasing a portion of the two prior bond offerings at a cost of $1.16 million in order to preserve their tax-exempt status.

SEC Enforcement Activity and Lessons Learned

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- The City's settlement with the SEC included undertakings requiring the retention of an independent consultant, who for three years will conduct annual reviews of the City's policies, procedures, and internal controls regarding its disclosures for municipal securities offerings, including:
- (i) disclosures made in financial statements; (ii) disclosures made pursuant to continuing disclosure agreements and disclosures regarding credit ratings; (iii) the hiring of internal personnel and external experts for disclosure functions; (iv) the designation of an individual at the City responsible for ensuring compliance by the City of such policies, procedures, and internal controls; and (v) the implementation of active and ongoing training programs for, among others, the City Attorney(s), the City Manager, the Mayor, the City Finance Director, and the City Commissioners regarding compliance with disclosure obligations.

SEC Enforcement Activity and Lessons Learned

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Greater Wenatchee Regional Events Center Public Facilities District, Piper Jaffray & Co., and Others (11/5/13)

- SEC charged District with misleading investors in a bond offering that financed the construction of a regional events center and ice hockey rink.
- According to the SEC's Order, in 2011, the District defaulted on $41.77 million in Bond Anticipation Notes ("BANS") it had issued in 2008 to finance the construction of the center.
- The 2008 Official Statement for the BANS was materially false and misleading because it stated that there had been no independent reviews of the financial projections for the center when in fact, an independent consultant twice examined the projections and raised questions about the center's economic viability.
- The Official Statement also failed to disclose that financial projections had been revised upward based in part upon optimistic assurances by civic leaders that the community would support the project.

SEC Enforcement Activity and Lessons Learned

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- In addition, the Official Statement omitted key information about the possibility that the City of Wenatchee's remaining debt capacity of $19.3 million would limit its ability to support any future long-term bonds.
- SEC also charged a senior staff member who was the Contracts Manager for the District and had executed a Closing Certificate attesting that the Official Statement did not contain any untrue statement of material fact or omit to state a material fact.
- In addition, the SEC charged the outside Developer of the project and its President and CEO who signed a Certificate certifying that certain information in the Official Statement relating to the center and its revenue and tax projections was accurate.
- Furthermore, the SEC charged the underwriter Piper Jaffray and its lead investment banker for conducting inadequate due diligence and failing to form a reasonable basis for believing the truthfulness and completeness of material statements in the Official Statement.

SEC Enforcement Activity and Lessons Learned

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- All parties agreed to settle the SEC charges.
- The District's settlement included:
- Payment of a $20,000 penalty, which was the first time the SEC ever obtained a financial penalty against a municipal issuer
- Undertakings that included establishment of policies, procedures, and internal controls relating to disclosures in the offering of municipal securities and continuing disclosures pursuant to Rule 15c2-12, and ongoing training.
- Cease-and-Desist Order for Securities Act Section 17(a)(2) violations
- The District's Contract Manager settled to a Cease-and-Desist Order for Securities Act Section 17(a)(3) violations.
- The Developer settled to a Cease-and-Desist Order for Section 17(a)(2) violations and paid a $10,000 penalty.
- The Developer's President and CEO settled to a Cease-and-Desist Order for Section 17(a)(3) violations and paid a $10,000 penalty.

SEC Enforcement Activity and Lessons Learned

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- Piper Jaffray's settlement included:
- Payment of $300,000 penalty
- Censure and Cease-and-Desist Order for Sections 17(a)(2) and (3) violations
- Undertakings that included retention of an independent consultant to review policies and procedures
- Piper Jaffray's Lead Investment Banker's settlement included:
- Payment of $25,0000 penalty
- Cease-and-Desist Order for Sections 17(a)(2) and (3) violations
- Undertakings that included limiting certain activities as an associated person of a broker-dealer or municipal advisor for 12 months.

SEC Enforcement Activity and Lessons Learned

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City of Allen Park (11/6/14)

- SEC brought settled fraud charges against the City of Allen Park, Michigan, its former Mayor and its former Administrator alleging that a bond offering misled investors about the prospects of a failed $146 million movie studio project planned for the City.
- The SEC's cease-and-desist order against Allen Park found it violated Section 17(a)(2) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5(b).
- In determining to accept Allen Park's settlement offer, the SEC considered the City's cooperation with the SEC's investigation and certain remedial measures it had taken, including agreeing to:
- (1) adopt written policies and procedures drafted by disclosure counsel and provide a copy to the SEC Staff; (2) for two years following the entry of the cease-and-desist order, to have a designated individual sign, upon consultation with disclosure counsel, certifications that any offering documents do not contain an untrue statement of material fact; (3) disclose the terms of the order in offering documents for two years from the date of the order; (4) designate disclosure counsel responsible for training all personnel involved in the city's bond offerings; (5) conduct training of all personnel; and (6) certify to the Staff that the training took place and the titles of the attendees.

SEC Enforcement Activity and Lessons Learned

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- The SEC's complaint against Allen Park's former Administrator alleged that he reviewed and approved the offering documents in violation of Section 17(a)(2) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5(b).
- Without admitting or denying the allegations, the Administrator consented to a final judgment enjoining him from further violations of those provisions.
- Although he was not fined, he agreed to be barred from participating in any municipal bond offerings.
- SEC's use of broad form of equitable relief to obtain industry bars against municipal officials from participating in future bond offerings.

SEC Enforcement Activity and Lessons Learned

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- With regard to its complaint against Allen Park's former Mayor, the SEC, for the first time charged an elected official with control person liability pursuant to Section 20(a) of the Exchange Act for his role in a municipal bond offering.
- SEC alleged that although he did not prepare or sign the offering documents, the Mayor was liable as a control person under Section 20(a) of the Exchange Act for Allen Park's and its Administrator's Section 10(b) violations, based on his control of them and the fact that he actively championed the project through several misleading public statements.
- SEC alleged that Mayor also attended public meetings where the project was discussed, but never mentioned any problems or the project's change in scope.
- Without admitting or denying the allegations, the Mayor settled with the SEC, consented to a final judgment enjoining him from further violations of Section 20(a) of the Exchange Act and barring him from participating in any municipal bond offerings, and agreed to pay a $10,000 civil penalty.

SEC Enforcement Activity and Lessons Learned

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City of Harvey (12/5/14)

- SEC obtained an emergency injunction against the City of Harvey, Illinois and its Comptroller to stop an alleged fraudulent bond offering.
- First time the SEC sued an issuer to halt a municipal bond offering.
- The complaint alleged that the City and its Comptroller had been engaged in a scheme for several years to divert $1.7 million in bond proceeds from multiple offerings, the funds of which were supposed to be used to renovate a hotel and conference center in the Chicago suburb, but instead went towards the City's payroll and other general operating expenses.
- Also, the Comptroller allegedly received $269,000 of the bond proceeds while employed by the developer hired to rebuild the hotel.
- The SEC obtained the emergency relief to prevent the City from issuing more bonds using offering documents containing materially misleading statements about the purpose and risks of the bonds while omitting that past bond proceeds had been diverted.

SEC Enforcement Activity and Lessons Learned

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- The complaint charged both the City of Harvey and its Comptroller with violations of Sections 17(a)(1) and (3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 and also charged the City with violations of Section 17(a)(2) of the Securities Act.
- The City agreed to settle with the SEC, consenting to the entry of a final judgment enjoining it from committing future violations of the antifraud provisions.
- The City also agreed to retain an independent consultant and an independent audit firm, and will be prohibited from engaging in the offer or sale of any municipal securities for three years unless it retains independent disclosure counsel.
- In January 2015, the court entered a default judgment against the Comptroller ordering him to pay over $217,000 in disgorgement and penalty and barring him from participating in any municipal securities offerings as an adviser or consultant to any participant in such an offering.

SEC Enforcement Activity and Lessons Learned

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UNO Charter School (6/2/14)

- SEC charged UNO, a charter school operator in Chicago, with defrauding investors in a $37.5 million bond offering for school construction by failing to disclose a conflict of interest involving a pair of multi-million dollar contracts UNO entered into with two companies owned by two brothers of one of UNO's top executives.
- The SEC also alleged that UNO did not inform investors about the potential financial impact the conflicted transaction had on UNO's ability to repay the bonds.
- The SEC's complaint charged UNO with violations of Section 17(a)(2) of the Securities Act.
- UNO consented to a final judgment enjoining it from further violations of that provision and agreed to certain undertakings to improve its internal procedures and training, including the appointment of an independent monitor.
- The final judgment also contains a conduct-based injunction prohibiting UNO and its employees from engaging in any "conflicted transaction," defined as "any transaction in which any of [UNO's] officers, directors, agents, employees and family members use their position for a purpose that is, or gives the appearance of, being motivated by a desire for a private gain, financial or nonfinancial, for themselves or others, particularly those with whom they have family business or other ties."

SEC Enforcement Activity and Lessons Learned

ORRICK

West Clark Community Schools and City Securities (7/29/13)

- Settled enforcement actions against an Indiana-based school district and its underwriter.
- SEC's Order found that West Clark executed a Continuing Disclosure Agreement in connection with a $52 million bond offering in 2005 in which it undertook to annually disclose certain financial information, operating data and event notices
- In an Official Statement for a $31 million bond offering in 2007, in a section entitled "Compliance with Previous Undertakings," West Clark stated that in the previous five years, it has never failed to comply, in all material respects, with any previous undertakings.
- In fact, between 2005 and 2010, West Clark never submitted any of its contractually required disclosures.
- West Clark consented to a Cease-and-Desist Order and undertakings that included adopting enhanced written disclosure policies and procedures and implementing annual training for personnel involved in the bond offering and disclosure process.
- This case was the first time the SEC charged a municipal issuer with falsely stating to bond investors that it had been properly providing annual financial information and notices required as part of its prior bond offering.

SEC Enforcement Activity and Lessons Learned

- SEC also charged the underwriter, City Securities, stating that it conducted inadequate due diligence and, as a result, failed to form a reasonable basis for believing the truthfulness of material statements in West Clark's Official Statement, and in particular, its assertion that it complied with its prior continuing disclosure undertakings, a fact that City Securities could have easily verified through a review of public repositories.
- As a result, City Securities disseminated the materially false Official Statement to its customers.
- In addition, City Securities recommended the purchase and sale of municipal securities without implementing adequate procedures and without taking steps required by Rule 15c2-12 to reasonably ensure prompt receipt of issuers' disclosure submissions.

SEC Enforcement Activity and Lessons Learned

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- The SEC's Order also contains findings that City Securities engaged in other misconduct, including: fraudulently mischaracterizing expenses for entertainment, charitable donations and gratuities as expenses for "Printing, Preparation and Distribution of Official Statement," so as to obtain reimbursement from bond proceeds without the issuers' knowledge; and providing improper gifts and gratuities to personnel of certain municipal securities issuers such as multi-day, out-of-state golf trips and tickets to multiple sporting events.
- City Securities settlement with the SEC included an Order finding violations of the antifraud provisions, Rule 15c2-12, and MSRB Rules G-17 and G-20, payment of nearly $580,000 in disgorgement and penalties, and undertakings to implement changes recommended by an Independent Compliance Consultant to ensure future compliance with federal securities laws.
- SEC also charged the Supervisor of City Securities' Public Finance & Municipal Bond Department who consented to a permanent supervisory bar, one-year industry bar, and payment of $38,475.

SEC Enforcement Activity and Lessons Learned

ORRICK

SEC's MCDC Initiative

- On March 10, 2014, SEC announced the MCDC Initiative to encourage municipal issuers and underwriters to voluntarily self-report materially inaccurate statements made in bond offering documents regarding prior compliance with continuing disclosure obligations under Rule 15c2-12.
- Deadline for underwriters was September 10, 2014 and deadline for issuers was December 1, 2014.
- In exchange for self-reporting, more favorable and standardized settlement terms would be given to issuers and underwriters.
- SEC would not recommend civil penalties for issuers participating in the MCDC Initiative and would agree to a set civil penalty schedule for participating underwriters based on the size of the offering and the amount of the underwriter's total revenue and capped at $500,000.

SEC Enforcement Activity and Lessons Learned

- For eligible issuers, the settlement must include undertakings 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 Enforcement Division regarding the false statements, 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 SEC 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.

SEC Enforcement Activity and Lessons Learned

ORRICK

- For eligible underwriters, the settlement must include undertakings to:
- retain an independent consultant, not unacceptable to the SEC 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 SEC staff to not adopt recommendations that the underwriter can demonstrate to be unduly burdensome;
- cooperate with any subsequent investigation by the Enforcement Division regarding the false statements, including the roles of individuals and/or other parties involved; and
- provide the SEC staff with a compliance certification regarding the applicable undertakings by the underwriter on the one year anniversary of the date of institution of the proceeding.

SEC Enforcement Activity and Lessons Learned

ORRICK

- SEC warned that those issuers and underwriters not participating in the MCDC Initiative, but who are responsible for materially inaccurate statements concerning prior disclosures, may be subject to increased sanctions.
- In particular, SEC stated that it will likely seek financial sanctions against issuers and the financial sanctions against underwriters will likely be greater than the ones set forth in the MCDC Initiative.
- MCDC Initiative only covered issuers and underwriters.
- Did not cover individuals associated with those entities.
- Determinations regarding individual liability will be made on a case-by-case basis, assessing all facts and circumstances, including evidence of intent and other factors, including cooperation.

SEC Enforcement Activity and Lessons Learned

ORRICK

First Settlement with Issuer Under MCDC

- On July 8, 2014, the SEC brought first MCDC settled enforcement action against Kings Canyon Joint Unified School District.
- SEC charged that King's Canyon misled bond investors about its failure to comply with its continuing disclosure obligations under Rule 15c2-12.
- SEC found that Kings Canyon violated Section 17(a)(2) of the Securities Act because a 2010 bond offering document contained an untrue statement of material fact that issuer was in compliance with continuing disclosure obligations related to earlier bond offerings.
- In reality, the school district failed to submit some of the required disclosures over a three-year period.
- Without admitting or denying the SEC's findings, Kings Canyon agreed to cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and to certain undertakings under the terms of the MCDC initiative, including agreeing to:

SEC Enforcement Activity and Lessons Learned

ORRICK

- Establish written policies, procedures and training regarding continuing disclosure obligations within 180 days;
- Comply with existing continuing disclosure undertakings and bring all prior filings up to date within 180 days of the institution of the proceedings;
- Cooperate with any subsequent investigation by Enforcement regarding the false statements, including the roles of individuals 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 for five years following the settlement; and
- Provide the SEC staff with a compliance certification regarding the applicable undertakings on the one year anniversary of the date of institution of the proceedings.
- The Kings Canyon Cease-and-Desist Order did not explain or describe what the District's continuing disclosure undertaking failures were or why the misstatements in its official statements were material.
- In the wake of the Kings Canyon settlement, practitioners expressed frustration over what they described as a vague order and called for additional guidance from the SEC.

SEC Enforcement Activity and Lessons Learned

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Three Waves of MCDC Settlements With 72 Underwriters

- On June 18, 2015, the SEC announced settled enforcement actions against 36 underwriters.
- On September 30, 2015, the SEC announced settled enforcement actions against 22 underwriters.
- On February 2, 2016, the SEC announced settled enforcement actions against 14 underwriters.
- The SEC alleged that the firms violated securities laws by using offering statements containing materially false statements or omissions about the bond issuers' compliance with continuing disclosure obligations.
- The SEC also alleged that these firms failed to conduct adequate due diligence in identifying the misstatements and omissions prior to offering and selling the bonds.
- As part of the settlements, the firms neither admitted nor denied the findings, and agreed to cease and desist from such violations in the future.

SEC Enforcement Activity and Lessons Learned

- The penalties against the firms ranged from $20,000 to the maximum $500,000.
- Each firm also agreed to retain an independent consultant to review its due diligence policies and procedures with regard to municipal securities underwriting.
- Each settled order cited between one and three examples of improper disclosure by an issuer or obligor.
- Most examples involved a misstatement or omission in an official statement where the issuer or obligor had either failed to file or had been late in filing required annual financial reports, audited financial statements, operating data, or other required financial information.
- Only one example referenced a failure to file a material event notice.
- SEC has stated that examples in settled orders are intended to provide broad guidance regarding the SEC's views on materiality rather than set forth any bright line test.

SEC Enforcement Activity and Lessons Learned

- In the February 2nd press release announcing the third and final wave of underwriter settlements, Andrew Ceresney, Director of the SEC's Enforcement Division, stated:
- "The settlements obtained under the MCDC initiative have brought much-needed attention to disclosure obligations in municipal bond offerings. As part of the settlements, 72 underwriting firms – comprising approximately 96% of the market share for municipal underwritings – have agreed to improve their due diligence procedures and we expect that investors will benefit from those improvements."

- The SEC has indicated that settlements with issuers are forthcoming.

Benefits of Disclosure Policies and Procedures

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- Improves quality of disclosure
- Facilitates compliance with disclosure obligations under the federal securities laws
- Can help prevent violations from occurring
- Can provide a defense to an SEC action or be a mitigating factor that the SEC could consider in deciding whether or not to bring an action, which violations to charge, or what relief to seek
- Robust policies and procedures that promote full and transparent disclosure can be a positive factor that rating agencies and others in the market consider in determining ratings and pricing, and may result in possible lower cost of capital