CDIAC Webinar Transcript
Securities and Exchange Commission (SEC) Municipalities Continuing Disclosure Cooperation Initiative: A Call to All Municipal Issuers
April 28, 2014

(Editor's Note: This transcript has been prepared by the California Debt and Investment Advisory Commission (CDIAC). CDIAC believes it to be a fair and accurate reproduction of the comments of the speakers. Any errors are those of CDIAC and not the speakers themselves.)

On March 10, 2014, the SEC announced a new cooperative enforcement initiative designed to encourage any issuers and underwriters of municipal securities to self-report certain violations of the federal securities laws. Issuers and underwriters have up until September 10, 2014, under the Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative") to self-report materially inaccurate statements in a final official statement regarding the issuer's prior compliance with its continuing obligations as described in Rule 15c2-12. The SEC offers no assurances to issuers and underwriters who do not take advantage of the MCDC Initiative.

CDIAC conducted a webinar to provide information on the MCDC Initiative, including: the origins of the MCDC Initiative and why it is advantageous for issuers and underwriters to participate; whether issuers and underwriters should consider self-reporting under the MCDC Initiative; and the process of self-reporting under the MCDC Initiative.

Slide 1 – SEC Municipalities Continuing Disclosure Cooperation Initiative: A Call to All Municipal Issuers.

Mark Campbell: Good morning everyone, this is Mark Campbell, the Executive Director of the California Debt and Investment Advisory Commission. I want to welcome you to our webinar on the SEC Municipalities Continuing Disclosure Cooperation Initiative. This is an opportunity to speak directly to the SEC about this very important program. We are pleased to offer this. The program is set up in a facilitated discussion, and I will introduce the speakers here in just a moment.

I want to take a minute to both introduce CDIAC to those who are on the line that may not be familiar with CDIAC. The California Debt and Investment Advisory Commission is an independent commission under the State Treasurer. In California the State Treasurer is the chair. We offer both education and research and we also collect data and serve as the state's clearinghouse for public debt issuance.

We have in the last year introduced a webinar component to our education program so we certainly open that to both the California public and private municipal community, as well as those outside. We've made an effort in this program to outreach to municipal issuers and private sector participants outside of California because we know the importance of this topic. So again, I want to welcome everybody.

By way of housekeeping, I want to recognize the slide that you are viewing now. If you do have technical issues contact GoToMeetings. There is a one-eight hundred number or a web link. We offer live captioning also available through that web link. And lastly, if you need a certificate of attendance, please e-mail us at cdiac@treasurer.ca.gov, and we will follow up quickly with that.

I am going to introduce the speakers and get out of the way so they have the opportunity to cover this topic.

Slide 2 - SEC Municipalities Continuing Disclosure Cooperation Initiative: A Call to All Municipal Issuers. (02:31)

Dan Deaton is going to serve as our facilitator. Dan is a partner in the public finance group, Nixon Peabody. He represents governmental agencies; non-profit corporations, underwriters and others as bond counsel, disclosure counsel and underwriter counsel, and a wide variety of tax exempt and taxable public finance transactions.

With him is Peter Chan, Assistant Regional Director - Division of Enforcement with the Securities Exchange Commission. Peter has served in that position in SEC's Chicago regional office since 2000. He heads the Chicago regional office's Municipal Securities Public Pension Unit. Prior to joining the SEC, Peter was an attorney in the corporate and securities department of Baker and McKenzie.

So with that, I am going to turn it over Dan and Peter and thank you very much.

Slide 3 - SEC Municipalities Continuing Disclosure Cooperation Initiative: A Call to All Municipal Issuers. (03:32)

Dan Deaton: Thank you, Mark. What Peter and I have done is we've divided this discussion today into two parts. We are going to go through a quick PowerPoint to lay out the basics of the MCDC Initiative.

Slide 4 – What is the MCDC Initiative? (03:50)

Keeping in mind that the primary purpose of today's call is to make sure as many people as possible are aware that the Initiative exists, and the value it can be, and the importance of understanding what it is for and why it would make sense for people to take advantage of it.

We are going to go through a PowerPoint. I'm going to ask Peter to lay out from his perspective what the MCDC Initiative is. Then after that I'm going to ask a series of questions to Peter that are a lot of the pressing questions that I personally have had, but also that I have heard in my comings and goings in my daily life of concerns and issues that people have.

We also will be monitoring the chat box, so if people do have questions we will do the best we can to get to those depending on time. We will try to leave some time at the end to try to address most questions.

Okay Peter, so let's start. Stepping back, can you give us a general description of what is the MCDC Initiative and why does it matter to issuers and underwriters?

Slide 5 - What is the MCDC Initiative? - *Municipal Continuing Disclosure Compliance Initiative of the Division of Enforcement of SEC* (05:00)

Peter Chan: Sure Dan. First of all, I want to thank CDIAC for inviting me for this webinar. Obviously these are my views and not necessarily the views of the Commission or the staff. The MCDC Initiative is a very unusual initiative from the Division of Enforcement of the SEC. Basically, we are focusing on false certification in offering statements, dealing with compliance with continuing disclosure obligation by the municipal issuer. What we are doing right now is we are basically telling the underwriter community and the municipal issuer community that there is a six-month opportunity for underwriters and issuers that have been involved in the false certification of continuing disclosure compliance, to come in and self-report to the Division of Enforcement, the existence of these violations.

If that self-report takes place within the six-month period, both the underwriter who self-reports and the issuer who self-reports will get favorable terms of settlement that are predictable and, very importantly, these settlement terms will not be available after the six-month period. After the six-month period, if the Division of Enforcement identifies through investigations similar violations and the entities have not previously self-reported, we are going to come down against those entities with a ton of bricks (i.e. with very serious sanctions). So this is an opportunity to clear the slate for favorable, light settlement terms that the Division of Enforcement will recommend to the Commission, and after the six months all bets are off.

Dan Deaton: Okay, thanks Peter. Because this is sort of an area in which there has been some confusion, you really have a couple of layers of things that are going on: You have offering documents; and you've got continuing disclosure compliance. Can you give us a really good description of exactly what are the kinds of violations that the federal securities law, the MCDC

Initiative is intended to cover? What is it that people should exactly be looking for as they are considering this Initiative?

Slide 6 - What is the MCDC Initiative? - *Misrepresentations in offering documents may constitute violations of the federal securities laws* (07:27)

Peter Chan: That's a very good question. Let's talk about what this is not. The violation does not involve not having done the filings based on continuing disclosure. That's not the violation, that's the specific legal focus. The legal focus is a false statement. So as many of you know, in an offering statement, during the municipal securities offering, there is a compliance certification stating that the issuer, in the last five years, has complied with the continuing disclosure obligations. If that statement is false, so for instance, if the issuer has actually not been making the annual filings, that statement would be false under the Federal Securities Law. That would be considered fraud under the Federal Securities Law under the anti-fraud provisions.

So, basically the violation we are going after is a false statement about prior compliance with continuing disclosure.

Dan Deaton: Okay, great. And I think one of the points that Peter and I have talked about is that when offerings state that an issuer is in material compliance, investors are purchasing bonds with an assumption of that set of facts and it's that purchase by the investors on that set of facts that really is the issue that the SEC is targeting.

Peter Chan: Very much so. The way to look at this is that investors, when they are reading the offering statement, one of the things that they are reading is exactly the certification, so when they buy the particular bond, they are getting the comfort of knowing that that particular issuer had previously been in compliance with the continuing disclosure. That is very material to the bond buyer, because then the bond buyer knows there is a fair expectation that they will be able to get continuing disclosure from the issuer in the future. As part of this, they also know that the underwriter had provided adequate due diligence to ensure that that certification is accurate. So all in all, it's a very important certification.

Dan Deaton: Okay, great. What exactly is the SEC offering to issuers and the underwriters in the MCDC Initiative? What is the offer here?

Slide 7 - What is the MCDC Initiative? - *Issuers* (09:56)

Peter Chan: Right, so basically what we are offering and we have basically said in previous speeches that "you can take it to the bank" if you self-report, is that, if you are an issuer that is self-reporting a violation, as described, you are dealing with the inaccurate certification, there are a number of very favorable terms that we will recommend to the Commission.

The key being, and this is very important, we will not recommend any financial sanctions against the issuer. And so, if the issuer self-reports, the one key settlement term that they can get a guarantee on is that we will not recommend any monetary sanctions, penalties, and so forth. In exchange as part of this settlement terms, the issuer will also agree to implement procedures to improve continuing disclosure in the future and also training, but also to correct past deficiencies and update their filings. Basically there will be an entry of neither admit nor deny administrative order as part of the settlement.

The other key thing here is that the violation that we will recommend, will be a violation based on negligence. So if the issuer comes in with no penalty, and they need to do procedures and neither admit nor deny, and very importantly, it will be characterized as negligence as opposed to intentional conduct, which in many fraud cases we have often recommended intentional fraud actions.

Dan Deaton: Okay, very helpful. That's a great clarification. What about underwriters?

Slide 8 - What is the MCDC Initiative? - ***Underwriters*** (11:48)

Peter Chan: Well underwriters are both similar and dissimilar. So again, if an underwriter self-reports during the six month period, one thing we can guarantee is a recommendation to the Commission that there will be a predictable penalty of financial sanctions. So unlike the issuer, there will be financial sanctions against the underwriter. But with the underwriter it is a very predictable set.

So for instance, for municipal offerings of $30 million and below, we will recommend a penalty of $20,000 per violating offering. For offerings above 30 million, we will recommend $60,000 per violating offering against the underwriter. What we are also doing, and again this is a very favorable term in my mind, is that we are putting a cap of $500,000 of civil penalty against underwriters. So for instance, if an underwriter has underwritten, unfortunately, let’s say 30 violating offerings involving false certification, that underwriter will not have to pay above $500,000 of civil penalty, that’s a cap.

I think similar to the issuers, there will also be an undertaking to improve procedures and other actions, and with the underwriters, the one key undertaking is that the underwriter will agree to hire an independent compliance consultant who will look into the due diligence procedures of the underwriter and make recommendations. And also for both the issuers and the underwriters, they will agree to cooperate with any related SEC investigation dealing with the particular offerings. Again, neither admit nor deny, and it will be in the form of an administrative order, and again very importantly, it will be characterized as negligence, as opposed to intentional conduct.

Dan Deaton: Okay. Thanks Peter. Now, focusing on the issuers for this purpose, for this presentation that's primarily directed to issuers, what would an issuer have to agree to in order to take advantage of the MCDC Initiative? With this settlement agreement that you would be recommending, what does the SEC require the issuers to be willing to agree to in that settlement agreement?

Slide 9 - What is the MCDC Initiative? - *What are the undertakings for the issuers?* (14:17)

Peter Chan: I think knowing that there will be no penalty, I think the key component involves the undertaking. So for instance, the issuer will have to establish appropriate policies and procedures and training regarding continuing disclosure obligations within 180 days of the institution of the settlement. They have to comply with their existing continuing disclosure undertaking, and they need to obviously update past delinquent filings, again within 180 days of the institution of the proceedings. The issuer will have to cooperate with the SEC's subsequent investigation dealing with the particular false statements, including the roles of individuals or other parties that were in the offerings, if such an investigation is necessary. And also, the issuer in future offerings will have to disclose in a clear and conspicuous fashion the settlement, so that the investment community is aware of the settlement. And there has to be a compliance certification and undertaking at the one year anniversary of the settlement and very obviously they will have to agree to cease and desist from future violations of the federal securities law.

The way to look at, particularly, the undertaking, on procedures on training, and so forth, to be perfectly honest, these are things that the issuer should already have been doing to begin with as best practice. So, one way of looking at the undertaking is that these are things, if regardless of the settlement, if you haven't been doing it, you should be doing it to ensure best practice.

Dan Deaton: Okay, thanks Peter. Now, if an issuer or underwriter wants to self-report, what do they need to do?

Slide 10 - What is the MCDC Initiative? - *How do you self-report?* (16:08)

Peter Chan: Well, with our website and also with the press release, that's the MCDC Initiative. We have a questionnaire that the issuer will need to complete and file with us, preferably, by e-mail, by midnight of September 10th [2014].

And Dan as you mentioned, that's really September 9, 2014, so six months or so from now. And that questionnaire, it actually basically identifies some very fundamental information including the particular municipal securities offerings that contains the inaccurate statements, the identity of the issuer, contact information, but also other participants in [the] offering, the underwriter, the bond lawyers, the disclosure counsel, if any, and any financial advisor and so forth. So, enough to give us a sense as to what offering we are dealing with and who we are dealing with and also we have an optional part of the questionnaire where the issuer is free to provide any additional information that the issuer believes might be helpful to the SEC in looking at the self-report.

Slide 11 – An Example (17:30)

Dan Deaton: Okay, thanks Peter. Now you have worked, while at the SEC, you worked on the West Clark Community Schools example, which in many respects sort of is part of the origins of trying to deal with the issues (Editor's Note: Issues underlying the MCDC Initiative). Could you kind of [you] walk us through what happened in the West Clark Community Schools, and why it serves as a good example of the type of violation that the SEC is trying to look at here and try to zero in on?

Peter Chan: Sure, I led the investigation by the SEC involving the West Clark Community Schools District, which is a district in Southern Indiana. And what happened is that we discovered that in West Clark's 2007 offering, the offering statement, as typical that we see has a compliance certification certifying that West Clark had been in compliance with its disclosure obligations under the continuing disclosure agreement, that it executed in [a] previous bond offerings. And in this case, the previous offering was in 2005. What we have discovered is that West Clark has not submitted any of the required annual reports or notices pursuant to the CDA or continuing disclosure agreement undertaking.

So, as a result of the investigation, we recommended, and the Commission instituted, enforcement action as a settle case against West Clark. And in that situation, it was for what we call 10b, which is intentional reckless conduct against West Clark for violation of the Federal Securities Law.

We also, for the same reason, have enforcement action against the underwriter, an Indiana underwriter firm called City Securities, and we went after the underwriter for, again, the antifraud provisions of the Federal Securities Law because it had not performed adequate due diligence of the offering. As many of you know an underwriter, when it does an offering, is basically telling the market that they have performed adequate due diligence, and when we see something as, frankly, straightforward as a false certification involving continuing disclosure, we used this as a basis as a fraud case against City Securities for inadequate due diligence.

Just so you know as part of that case, we also found other violations dealing with City Securities that are unrelated to West Clark, including improper gifts and benefits to other issuers and also improper characterization of expenses to issuers. As part of the underwriter settlement, in addition to over $300,000 of civil penalty plus the disgorgement of profits, we also went after the head of the Municipal Finance Department of City Securities, and he is forever barred from being a supervisor in the securities industry again, and he has agreed to a time out of one year from acting or associating with broker dealers in the financial sector for a year. So, very serious sanctions against the underwriter in particular, in that case.

I think the key here is again, looking at West Clark, we didn't go after West Clark for not having filed the annual filings, we went after West Clark for lying about the fact that they were in compliance, when in fact West Clark was not.

Dan Deaton: Okay, perfect. Thank you so much Peter. Does the MCDC Initiative cover both an issuer as well as the staff and officials of an issuer?

Slide 12 - What Are Some Things to Know (21:34)

Peter Chan: That’s a very good question. So the answer is that the MCDC Initiative only covers the entity, in this case the issuer and not any individuals. I think the reason why, is that as we discuss in our Initiative announcement, when assessing whether an individual should be charged and whether there is even a violation is a very nuanced, case-by-case analysis depending on the facts and circumstances of the case. So as part of this Initiative, it covers the issuer but not the individual.

However, as we stated in the Initiative, we don't necessarily automatically charge an individual. We always look at the individual accountability and liability to make a determination, and some of those factors, for instance, include the level of intent and knowledge of the particular individual; the level of culpability of the individual, and whether there are any extenuating circumstances, and whether the individual cooperates with the SEC. A variety of factors beyond what I just listed.

So, for instance, if an individual, if an issuer, self-reports and we find out that an individual, let’s say an official with the issuer, was well aware that the certification was false, and nevertheless decides to take action to make that certification in the offering statement, I think there is a very strong likelihood we will recommend action against the individual.

On the other hand, there are circumstances that would point to maybe not taking action against the individual. I don't want to necessarily go into that, but very often it does involve the evidence dealing with knowledge, intent, culpability, and, of course, cooperation.

Dan Deaton: Okay, very helpful. And if an issuer thinks that it can take advantage of the MCDC Initiative, what should it factor into that decision as to whether to file or not?

Peter Chan: Yeah, I think the key here – let's start with one basic concept, which is, if an issuer is thinking about self-reporting, that means the issuer, in consultation with counsel and lawyers, thinks that there is a definite possibility that it has violated the federal securities law through the false certification. So obviously that is a threshold step, because if an issuer was late in filing, but had not made any false or inaccurate certification, then obviously there is no cause to self-report. But assuming that the issuer thinks there is a definite likelihood that there is a violation in terms of false certification, I think one factor to consider is the fact that if the issuer does not self-report in the six month period, they need seriously consider the fact that after the six month period there will be absolutely no assurance on the settlement terms provided by the MCDC Initiative.

In fact, I can pretty much guarantee that after the six-month period, if we find out that an issuer had violated the federal securities law through a false compliance certification in the ways we described in this session, and we find out that the issuer did not self-report, I can guarantee you that the Division of Enforcement, if the evidence supports violation, will recommend very, very serious enforcement sanctions definitely beyond the settlement terms that we are providing through the Initiative. In fact, there is an extremely strong likelihood that we will recommend financial sanctions in terms of civil penalties and other financial sanctions against that issuer. So that is a cause and benefit approach that I think the issuer definitely needs to consider.

And I think the other consideration is that, and that's why I think it is important to look at the six month period as an opportunity, without this Initiative I think the community, the industry, needs to know that the SEC will be going after issuers and underwriters moving forward as we have done in West Clark and City Securities, for false certification dealing with continuing disclosure compliance. So that’s a guarantee.

So in that sense, there will be substantial enforcement activity no matter what after the Initiative. So again, think of this Initiative as a possible opportunity to clear the slate; for the issuers to deal with very predictable settlement terms.

Slide 13 - What Should Issuers Do? (26.45)

Dan Deaton: Okay, thanks Peter. Okay, then what I figured I would just do is just probably, just real quickly, rattle off the rest of these slides here and then we will get to the other questions.

Slide 14 - What Should Issuers Do? - *Did you do an offering in the last five years?* (26:56)

Dan Deaton: So, given the serious nature of this, issuers should be asking themselves, did you do an offering in the last five years? And if you did do an offering in the last five years, were you subject to continuing disclosure undertaking before that offering? And were you in compliance with that continuing disclosure undertaking in terms of timely filing the annual reports, making sure the annual reports included everything, and timely filing material event notices? And if there was any noncompliance, if there's noncompliance as such, that doesn't address the issue here. That is not what the MCDC Initiative is about. But if there were instances of material noncompliance, were those properly and appropriately disclosed in the offering document that was done, that was then used to sell an additional series of bonds to investors?

If you find that there is a concern along these lines, the MCDC Initiative is an opportunity to resolve this problem. Because the SEC is going to recommend favorable settlement terms and give an opportunity for the issuer to be able to address that problem with the undertakings in the terms of the MCDC Initiative, but with those favorable terms.

Slide 15 - What Do We Recommend? (28:14)

Dan Deaton: So what do we recommend? And one of the reasons why I am doing 14 and 15 is that Peter at the SEC can't do this. So let me just – coming from my perspective, I think issuers should be aware of whether or not they've got misstatements concerning their continuing disclosure compliance. This Initiative ends very quickly and the results after this Initiative could be substantial. The SEC has assured us, as Peter once again said, that there will be substantial increases in the SEC enforcement activity in this area and the terms of the enforcement action is very likely to be very different than what is being done with the MCDC Initiative.

The other strong recommendation that I would like to make is, contact your bond counsel and your disclosure counsel, and your city attorney, county counsel, or general counsel. Don't proceed without legal advice. Filing an MCDC Initiative is not an innocuous action. It carries significant legal consequences and significant, and needs to be thought through in a thoughtful way, understanding all of the legal issues that are at stake.

Slide 16 - What Do We Recommend? – *continued* (29:23)

The other point that I would just raise is that be sure to be in communication with your underwriters for your bonds that were issued in the last five years. Underwriters are in the process of figuring out among all of their deals, what they need to be doing. As a consequence for [that] the communication between the issuers and underwriters to be challenging at this time, given just the amount of burden that it takes to process through everything that needs to be done.

If an issuer is going to file for a bond issue under the MCDC Initiative, the underwriter will want to know that. And if the underwriter is going to file, then the issuer wants to know that. So, I think it is going to be very important [for] both issuers and underwriters be in good communication with one each other to know what they are doing, so that no one is sort of, in a situation of not realizing that the other has filed, and the other did not think that it was material in dealing with that post Initiative.

Okay, very good! With that I want to shift to a series of questions:

So Peter, why is the SEC doing this Initiative instead of just bringing enforcement actions?

Peter Chan: You know it's interesting that you asked that question because when I finished up with the West Clark investigation, one of the things, you know, again, just speaking very generally, that I became aware of, was that West Clark was not an aberration. I think both the SEC Municipal Securities Market Report, but also what we increasingly were finding out, the false certification continuing disclosure was looking like it may be a widespread problem with both [with] issuers and also with underwriters. And so, one very traditional thing we could do is to just stop bringing those cases and bring in increasingly tough sanctions to create deterrence. But we thought that in light of the nature of the violations, but also the type of entities involved, we thought it innovative, but also efficient and hopefully a fair way of dealing with this, was for this Initiative to take place, so to provide an opportunity to clear the slate for both the underwriters and also the issuers.

Now, we thought this would make sense both for obviously the Division of Enforcement of the SEC, but also for the community because in a way it would, hopefully, provide a way for us to efficiently deal with the problem from the SEC's perspective. But at the same time, I don't necessarily get the sense that those who violate the law or the entities that violate the law in this particular setting, are truly bad actors.

We are seeing a lot of cases where it was truly negligence, and so we thought in that setting, it would make sense to provide grace periods. So, it's a grace period with a bite, it is not an amnesty obviously, because there will be settlement terms. But again, I cannot emphasize how unusual this is for the SEC. We are, in a leap of faith, providing this grace period for self-reporting hopefully, so that people can fairly, efficiently deal with this problem and come clean so that we can move on.

Dan Deaton: How much of the, what would you say, does the SEC have any sense as to, given the Municipal Market Report and a lot of the studies the SEC has done in the market, about what percentage of the market, how widespread from the SEC's perspective is this issue? Do you have any sort of sense of that?

Peter Chan: I don't think I can [give] you any quantifiable percentage. What I can tell you, I can tell that when I was sitting at my desk thinking of designing this Initiative to begin with, one of the reason that drove me to set this in motion, was because with the intelligence that we are getting through enforcement, we were alarmed. We were frankly alarmed at the number of entities that may have violated what the law [requires] through the false certification.

We are also alarmed by the regional diversity in the sense that it was not just happening in one geographic region. That it was all over the country. We were also alarmed by the fact that we are dealing with, from my intelligence, not just bad due diligence by a few underwriters, but by quite a number. And so again, I can’t give a percentage, but the sense to add some qualitative sense to it, I think what really drove us to develop this Initiative was the sense that -- two things: One is that issuers and the personnel with the issuers involved in the offering documents were frankly not paying any attention or sufficient attention to what they were certifying or what they were signing.

We had cases in which, you know, we have seen officials and issuers saying they had never read the offering statement when they signed it. We were also alarmed from a qualitative standpoint, finding out that underwriters were not doing much due diligence on the accuracy of the offering statement. So one way to look at this and it goes back to what we are trying to achieve in terms of changing the culture on disclosure, is that you know, we are very concerned about issuers who had no idea what the offering statement says.

We are also concerned about underwriters not doing due diligence. One way to look at the certification on continuing disclosure compliance is to look at it like the canary in the coal mine. If an issuer can falsely certify as basic as that, and if an underwriters due diligence is so poor that the underwriter cannot catch something as objective as continuing disclosure compliance, what else are they missing? So I think with this Initiative, we believe it is dealing with a widespread problem, but also a qualitatively alarming problem, and our goal is, bottom line, is to improve disclosure and improve underwriter due diligence.

Dan Deaton: One of the questions that I have heard was that, obviously it was the West Clark Community Schools last year, I think sort of every year, roughly in the spring (*laughter*) for whatever reason, there appears to be something that targets the importance of this issue, and dating back to May, 2010 and obviously there was in March, 2012, and then last year with West Clark Community Schools, and this year with the MCDC Initiative, that dating back now really two to three years, some people thought back as many as four years, really sort of picked up the importance of this issue and shifted their practices substantially, and many dealers implementing due diligence on this. We are seeing a proliferation of disclosure more and more and more as this picks up. Is that sentiment shared by the SEC that there has been a shift in this, but that's not important to the SEC, what's important is what was done in 2009, 2010 and 2011, even if that was changed, or is the SEC's perception that that shift has not actually occurred yet?

Peter Chan: Well, obviously, I cannot disclose information I have from ongoing investigations, and other intelligence that we have, but with that in mind, maybe I can attack that in a couple of ways. One is, you know, we are often encouraged by the industry, both the issuers and the underwriters, when they take steps on their own to improve the continuing disclosure practice, particularly in terms of the best practice that they have been begun. So that's a good thing.

I think one thing I do want to address is this issue of, well, you know maybe things were bad before 2010, but things are better, so really there is no problem. One thing I can tell you is that we think there has still been a problem, and this is not a data issue. The second thing and this is important, as much as people are saying they have improved their effort on continuing disclosure, let's go back to the basics of what this is about. This is about issuers and in connection underwriters, providing false certification in violation of the federal securities law in offering statements. Whether it is based on negligence or intent, the importance of our concern, aside from the underlying disclosure, is the fact that there were material misstatements and offering misstatements.

And so, while knowing that there was a 2010 release, and knowing that people are paying closer attention to continuing disclosure obligation, let's get back to the very basic fact that, beginning then and also with our continuing concern, how is it possible that regardless of whether people paying attention to continuing disclosure, that there could be materially false statements in connection to municipal offerings, both from the standpoint of underwriter due diligence and from the issuer? So I think my answer is nuanced, which is, we very much welcome the increased focus on continuing disclosure, but whether there was good focus on continuing disclosure or not, there should never, never, never have been false statements in the offering statements.

Just like there shouldn't have been a false certification by a public company, there should have never been a false certification by an issuer. And so, while we are encouraged by the increased focus, the underlying violation is not something novel in our mind.

Dan Deaton: Okay, very helpful. Let's talk about materiality for a second. How would you say, one of the difficulties that the market has is discerning what constitutes the material noncompliance with their continuing disclosure undertaking? And let me just start by saying, is the enforcement division going to give any guidance on what constitutes materiality for these purposes?

Peter Chan: No we are not. Just like, frankly if you look at all or many of our federal securities law enforcement actions, we don't necessarily go through specific details about what is material or not. One reason why is, typically, that is very fact specific and it depends on the situation. But I think in looking at this issue, you know one way to think about this is particularly in consultation with your counsel, if you first of all have been in compliance with the continuing disclosure and then subsequently said you are in compliance, obviously, that's no problem.

I think then, step two, which I think Dan is what you're looking at, is if you are the issuer or the underwriter and you find out that you were not in compliance with your CDA, the continuing disclosure agreement, is the noncompliance sufficiently material such that when you say you are in compliance it is a material false statement? We don't want to give sort of what we call a preview because frankly, what we don't want to do is promote any type of a gamesmanship where people come to us anonymously and say, "Well I'm thinking about self-reporting but you need to tell me whether I'm in violation or not." I think the better thing to do is, if you think there is a definite risk that there was a material noncompliance, material false statement, I think there is a definite argument that you should be self-reporting, knowing that, and this is very important, the Division of Enforcement is not interested in taking enforcement action if we don't think in our mind that there is a violation.

So, if the issuer or underwriter self-reports a particular offering, but at the same time is not sure that it is absolutely a material misstatement, we are happy to, after the self-report, have that dialogue with the issuer and the underwriter and their counsel. I think the caveat to that is, if we decide based on the discussion that there is a violation, our expectation is that the underwriter and the issuer will follow through and accept the settlement terms that we provide in the MCDC.

I think there are a lot of ways to slice and dice the materiality, but the sense I get is they are going to be ones that are rather obvious, and I think a lot of them will be. And I think ones that sort of slice and dice, my view is, unless counsel feels very comfortable that the SEC enforcement action, after six months, they can adequately defend the issuer and the underwriter in stating that there is no material false statement, I think at least from my perspective, it probably makes sense to self-report, and then have a good discussion with the SEC enforcement staff.

Dan Deaton: That raises sort of the question, which is, that if issuers and underwriters look at the prospect of materiality and there is a lot of confusion and chaos in the marketplace about what really constitutes materiality in this context just because of the disorganized nature of the fact patterns that are out there? Everything from missing CUSIP numbers, to two days late, to missing one table and so on, and so it becomes very difficult to assess materiality. There really has not been in this area, any sort of guidance from the SEC as to what constitutes materiality, neither from the Office of Municipal Securities [n]or from the Enforcement Division. So if the issuers and the underwriters basically say, "I am so intimidated by the prospect of what constitutes material, and I really don't have any confidence that any specific noncompliance is immaterial." Would you advise them to over-report? Would you advise them to start reporting without regard to materiality?

Peter Chan: Well, here is the way I look at it; I would quibble with the term "over-report". I guess the way I look at it is if there is a noncompliance particularly based on the CDA, and talking to counsel you are not comfortable that you have a great materiality argument, I think instead of calling it over-reporting, it probably makes sense to err on the side of self-reporting so that you are within this period and you can have the dialogue with the staff.

I guess, look, the way I look at it is, a couple of things: one is, there is a reason why terms, specific terms, are within a file of CDA. So, generally speaking, if there is a term in the CDA and you are not in compliance, you start asking the question as to whether the certification was accurate. And again as I mentioned before the problem, of course, is that most people when they certify, at the time, they were not thinking, well, is this material compliance or noncompliance? They actually never even thought about what they were certifying and then just falsely certified compliance.

Well, I think from my standpoint, the SEC enforcement staff is not interested in taking enforcement action when they don't think there is a violation. But we can't make that call unless we have a census to all the relevant facts. And I think it is very difficult to just objectify and say here is the guideline and so forth because sometimes it depends on the setting and depends on the market environment and it might depend on the type of bond investors and so forth. So, it is very fact specific and we are happy to have that dialogue.

And again, we have heard some defense counsel saying they don't think X and Y will ever be material, fine. In which case then, they should have the confidence to advise the client that there will not be a problem after six months and that there will be a very strong defense during the SEC investigation after the six months. If, in consultation, where frankly there are other experienced counsels out there, you're still not sure, I think that kind of says something about the risk. But my point is not necessarily to err on the side of over-reporting, but err on the side of self-reporting when you think there is a risk.

The reason why I don't want to use the word over- reporting is, so for instance, I don't know that we'll look particularly kindly if an underwriter knowing that it has already reached the $500,000 limit, just decides to say, "You know what, we are not even going to bother to look at whether we have complied or not complied in terms of prior certification. Let's just self-report all deals that we underwrote in the last five years without looking at whether there were any compliance issues." I think that is obviously, problematic for two reasons: one is, that it is probably not done in good faith; and two is, that type of reporting, knowing that one of the things the MCDC Initiative participant has to do is cooperate in the investigation. And so, we will expect among other things, for the self-reporting entity to discuss with us the particular types of noncompliance that they believe they have discovered. And so, we are perfectly fine with self-reporting when there is uncertainty, but we are certainly not interested in blind reporting just by not even taking a look at what happened in the past, if that makes sense?

Dan Deaton: That does make sense. But let me ask you a shade on that, which is, if the dealer does go through and vets its deals, and identifies and basically decides that it really can't have a cogent defensible definition of what constitutes materiality, recognizes the incentives of the MCDC Initiative, does have the $500,000 cap and the undertakings are sort of, there's the cooperation point that might mean that they have to do more because of more filings, but there is not more in terms of the penalties, and there is also the procedures are sort of more or less the same because they go to the due diligence process of the dealer. If they do go through a careful review of their deals, but they identify ones with non-compliances, so that there is a compliance issue, but sort of throw their hands up for the question of materiality, would the SEC Division [of Enforcement] look on that negatively?

Peter Chan: I don't think so, particularly, Dan, in this case if you are talking about the $500,000 cap, you are talking about the underwriter, not the issuer. I think the way we will look at it is if it is done, again, in good faith, that they are actually taking a look and it believes that there is some risk that there is a violation and an underwriter self-reports, then, I think that, frankly, makes a lot of sense, particularly in consultation with counsel. And, you know, again let's say if an underwriter reports thirty. You know, I think part of the dialogue could be the underwriter telling the SEC look, in these thirty offerings we know that there are let's say, fifteen that we are very comfortable that we screwed up and there is a material nondisclosure. And it's just the other fifteen that we think there is a risk.

We think there might be arguments about why it wasn't a material nondisclosure but we are not sufficiently comfortable such that we wanted to report these other fifteen. And by the way, of the fifteen, five is because they were delinquent after so and so days, five is because of X and Y, and five are because of that. And so we are self-reporting, but we are hoping that you'll consider other factors and have that dialogue. I think that would be a very reasonable discussion we can have. And in that case, the underwriter would be able to take advantage of the MCDC Initiative and yet at the same time be able to have a reasonable dialogue with the staff.

Dan Deaton: So let's talk about that then in terms of the potential diversions of interest then that exist between the issuers and the underwriters in that regard, because the issuers at that point, they may have one credit, maybe they did one deal, and the decision then to go in on one deal and be subject to all of the relevant provisions of the cease and desist provisions, the undertakings and everything, could obviously, it is an action of legal significance.

Whereas the dealer, on the other hand, has this incentive, both in terms of just not offering with a known definition of materiality to cap on the fact that the undertakings are to their systems and their processes, that really there's concern that there is a divergence between the underwriters and the issuers. How would you advise an issuer if its sitting there struggling with that decision in the face of an underwriter that sort of looks at all instances of noncompliance, doesn't decide that it's not going to make materiality decisions, carefully going through its deal to make sure that it's not as you are describing, just blindly filing for everything because what does it matter, but rather has gone through but has thrown their hands up on materiality? What about the issuer now, does the issuer have to file just because the underwriter filed? How would you advise an issuer in that situation?

Peter Chan: Well just as a technical thing, I obviously can't advise the issuers because they have to talk to the lawyers. But I think the way, here are my observations: I would one, dispute the fact that somehow the underwriter has less cost in terms of "self-reporting" because if you think about it, just as much as you, Dan, identify the fact that the underwriter incentivizes to report any possible violations because it has a $500,000 cap, let's take a look from the issuer with just one offering. There are absolutely no monetary sanctions, unlike the underwriters. So, I would actually quibble with the idea that there is a divergence of at least financial interest in that sense. I think along that line, both the issuer, I know there are concerns about potential reputational issues with the issuer, but that frankly applies equally if not more to an underwriter, where it's primary business is among other things, to tell the world that it can do good due diligence. So I would quibble with the idea that there is a divergence of interest.

Dan Deaton: Really quickly, hold on. I think if the underwriter files for fifteen deals versus thirty deals it doesn't affect the underwriter's reputation by filing for fifteen relative to thirty, whereas, if the issuer falls within that second half of the fifteen the underwriter doesn't know whether it applies or not. That's sort of a zero or all reputational issue for the issuer.

Peter Chan: I think that's fair. So my observation about what the issuer could be thinking, again it is going back to the basics. One is, if the issuer is fairly sure, again, that there is no violation, particularly in consultation with counsel, then there is nothing to worry about because frankly even with or without the self-report of the underwriter, the issuer needs to really think less about whether the underwriter self-reported or not, but more about six months from now, the fact that there is a decent chance, with the focus by Division of Enforcement, that maybe not immediate next year, there is a decent chance we will discover the potential violation. So whether the underwriter self-reports now or not, I know some people out in the security spot basically have almost lackadaisically, have said, "Well, why report because the SEC may not end up finding the violation?" My answer to that is: don't bet on it.

If anything that could be taken away from this Initiative is that we are very serious about this, and so I think people are very seriously taking their chances, if the bet is, if there is no self-report, we might not find it. I think the bet, at least if I am betting, is that we will find out about the violation, knowing that there is a robust examination program by the SEC, knowing that we continue to have whistle blowers contacting us, and knowing that we have great source of intelligence about violations. So I think folks who basically talk about, oh, if the underwriter self-reports, that that creates some tension for the issuer, because the truth is, we will find out probably at some point.

Then the question goes back to the basic, which is, if the issuer feels strongly that there is no exposure then there is nothing to worry about. If there is a risk, knowing that there are no financial sanctions right now, but potentially serious financial sanctions after six months, you know, that is a risk that the issuer should take into serious consideration. And I think, I guess, that my bottom line out of this is, look, we are not here to hold the hand of the issuer or the underwriter, but again think of this knowing that we are going to come in very hard against violators after six months, think of the six-month period as a rare opportunity in the history of the SEC enforcement, that you could actually come in, but also even whether you can come in or not, actually have an opportunity to do a cost benefit analysis and know exactly what the predictable terms of settlement would be under these six months.

So, I can't ultimately tell people what to do, because that's part of the benefit of this, it is an opportunity for predictable risk assessment, but ultimately people have to make their own decisions.

Dan Deaton: So I have about fourteen more questions that I'm not going to get to, and we’ve got about 622 questions through the chat room. So, what I’m going to do here Peter is ask you, because we are now technically at 11 o'clock pacific, 2 PM eastern, so I'm going to ask you three questions that have come in through the chat room, that we’ve sort of selected, and let me just rattle them off real quickly and you can answer them.

The first is: Will settlement deals be made public?

Peter Chan: Yes, it will be public.

Dan Deaton: Okay, settlement deals will be public. The issue that we really struggle with in our industry is the bond insurer downgrades. I don’t know if you are familiar with this fact pattern in 2008, 2009, are you able to make any comment as to how concerned people should be about bond insurer downgrades?

Peter Chan: Yeah, I think this, unfortunately, goes back to the materiality issue. We cannot provide you any assurance on that and I think that is something that you need to talk to ideally your counsel about. But one take away is we are not providing any assurance of no action.

Dan Deaton: And as your counsel, I don't have any better answer. Is there any difference in competitive sales for underwriters? This is a good question as well I thought.

Peter Chan: Yeah, versus negotiators. So here is the thing and, again, that is part of the fact pattern. That particularly with underwriters, counsel will be happy to discuss, particularly if there is a self-report. We at the SEC recognize that the obligations and duty of due diligence vary depending on the role of the particular underwriter, between lead versus non-lead, but also in terms of negotiated versus competitive, with competitive generally being less. The only thing I want to caution with competitive is that, I don't think there is any law or decision out there, whichever, [that] said the due diligence obligation of competitive is zero. And so I think, you know, part of the consideration is, again from the risk assessment standpoint, we are definitely recognizing the competitive. The level of obligation for underwriters is less, but it is not zero.

And so, I think again, it goes back to the facts and circumstances of the particular underwriting and the discussion with the counsel. I think it definitely lowers the risk for the underwriter, it is competitive. But I want to be careful in saying that. I don't think anyone ever looks at due diligence obligation as zero.

Dan Deaton: Okay. And statute of limitations, we talked about that. Could you talk about statute of limitations? And I think the important thing for people to keep in mind is the statute of limitations for when the offering document was done, not for the actual failure to file a continuing disclosure undertaking. Could you just comment on statutes for a little bit?

Peter Chan: Correct. So for instance, let's think about a bad case. If we file a lawsuit, let’s say against an issuer or an underwriter for this false certification, it would be exactly that. It would be for the false statement in an offering. Not for the failure to comply previously. So we generally speaking, with some exceptions, have a five year statute of limitation, particularly for seeking financial sanctions and so forth. So, if you apply that five year starting now, you will be looking at false certifications that took place within the last five years, let's say generally speaking, all the way back to 2009.

Dan Deaton: Okay. I'm going to ask one more question, it is sort of one of the ones that I have heard a lot. It goes to the question of individual liability. And I think that a lot of the supervisors at both issuers and dealers are struggling with the question of individual liability because they have to make the decision as to whether the issuer or the underwriter should file with MCDC or not, and if the supervisor makes the decision to file the MCDC Initiative. What I have heard from both issuers and dealers is they feel like they are offering themselves up on a silver platter because they are sort of going in filing, only then to expose themselves, which seems like an inherently bad decision. Can you comment on that?

Peter Chan: Sure, I think so. I think the unfortunate answer to begin with, but I think with some carrot is, it is what it is right? If there is a violation of the law, there is a violation of the law, and we will look carefully at the individual liability and if there is very low level of intent and culpability and extenuating factors, then we are less likely to recommend sanctions. But the facts are the facts, and we will figure that out.

But here is something to consider for the individual: one is knowing and, again, this is really the big take way from this Initiative, is the Initiative is just an efficient way for both sides to deal with the issue, both from an enforcement standpoint, but also industry [standpoint]. Again, I think the assurance I can give you, both from enforcement, but also a robust examination program, is that don't bet against us in terms of not finding the violation later.

So in that sense if I am the individual, maybe you can ask the question this way, is it better that you are the decision maker to decide for your underwriter to self-report now and cooperate? Or do you want to be the supervisor who made a decision against self-reporting, and when we do discover the violations we also find out that you are responsible for the underwriting due diligence, but also responsible for deciding for not to self-report? So kind of like an interesting cost benefit analysis.

I think the other thing I want to emphasize is the fact that hopefully, it is the entity making the decision. So I would think that if I am the supervisor and I am making the decision in part based on who gets affected by my own concern about individual liability, I, hopefully, would at least recognize particularly in discussion with the general counsel of the firm, that there might be some type of conflict, with such that people beyond me need to participate in a decision.

The third thing is again, we are not looking at this as some type of trap. Because again, our view is we are going to go after the right people no matter what, anyway. Part of it is we do look at individual liability on a case-by-case basis, we don't automatically sue individuals, but we do automatically assess individual liability, responsibility and accountability, and I think, you know, for instance, again, I'm using this as a rough example: If you knew that your compliance certification was false or that you were doing due diligence and it was false then, of course, you should expect enforcement action.

I think then there is a whole spectrum where you can see how we can come out different ways depending on a discussion. And also, where I notice that your due diligence was bad or nonexistent, and you were responsible for overseeing due diligence then, yeah, there is going to be exposure. And you know what, that's how it should be to begin with.

Dan Deaton: Okay. Well I think that at 11:10 a.m., I'm already in trouble. We are over at 2:00 p.m. Eastern time frame. Linda I think at this point it makes sense – Peter, thank you very much (Peter Chan: Thank you very much.) for all of the guidance and everything. Linda did you want to take it from here and close it out? Or how would you like to?

Mark Campbell: Yeah Dan, I am going to go ahead and make a few closing comments. I want to make sure everyone knows that we will make an effort to address the questions that we did not get to. So Dan and Peter I am hoping you will work with us to and we will post as we have in the past, post responses to questions we have received on our website. So for those that had submitted questions that we were not able to attend to, look for those on the website over the next couple of weeks.

The other thing is we have recorded this webinar. That webinar will again, be posted to the CDIAC website under the Education page. Give us a couple of weeks. We have to do a transcript of the webinar and post them simultaneously. So it does take a little bit of time.

Peter thank you very much for your willingness to directly address the MCDC to the municipal community. I think the fact that you were willing to speak directly to the folks, is a clear indication of the cooperative emphasis in this program. So, thank you.

Dan, thank you for standing in place of all of the municipal issuers and underwriters and focusing the questions and concerns that you both heard and anticipate acting [on] as counsel. So again, thank you both very much.

I want to recognize the CDIAC Education unit. They have done a great job both in pulling this together with short notice and in marketing this program nationally, and so to their credit.

Again, the listeners I would encourage you to sign up for our ListServ for future education programs and publications. You'd have continued access to the programs CDIAC conducts.

Lastly, to remind you if you need a certificate of attendance, please e-mail CDIAC at cdiac@treasurer.ca.gov.

Dan, Peter, any closing comments? I know there is still a lot to cover, but I again, want to thank you.

Peter Chan: Thank you very much.

Dan Deaton: Thank you.

Mark Campbell: Alright, with that we are closing the webinar and thank you for your attendance.