Finance Director Report to the City of Madison Board of Estimates
November 24, 2014

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

- In response to findings of fraudulent financial reporting by municipalities (e.g., San Diego, Harrisburg and Jefferson County, Alabama), the SEC has begun an initiative that requests all municipalities to review continuing disclosure statements on bond documents and report on any irregularities.

- Issuers that report by December 1, 2014, will avoid penalties if issues are identified by the SEC later. Bond underwriters are also responsible for reviewing this information, and are subject to significant financial penalties for failure to report issues.

- The City's financial advisor, Springsted, is responsible for filing various financial information with investor databases. Springsted has reviewed the filings of City financial information for the past 10 years, as required by the SEC.

- Due to the fact that City financial information for two specific years (2004 and 2007) was not filed in a timely manner (in some cases more than 5 years after it should have been filed), as well as notice of rating downgrades on City Water and Sewer Revenue debt, recognition of these irregularities will be filed with the SEC. These will ultimately be noted as false statements by the SEC and a cease and desist order will be issued.

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

- The standard settlement (Cease and Desist order) would come after the filing and would be presented to the Common Council in the form of a resolution.

Municipalities Continuing Disclosure Cooperation Initiative

Division of Enforcement

U.S. Securities and Exchange Commission

I. Introduction

The Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative") is intended to address potentially widespread violations of the federal securities laws by municipal issuers and underwriters of municipal securities in connection with certain representations about continuing disclosures in bond offering documents.

As described below, under the MCDC Initiative, the Division of Enforcement (the "Division") of the U.S. Securities and Exchange Commission (the "Commission") will recommend favorable settlement terms to issuers and obligated persons involved in the offer or sale of municipal securities (collectively, "issuers") as well as underwriters of such offerings if they self-report to the Division possible violations involving materially inaccurate statements relating to prior compliance with the continuing disclosure obligations specified in Rule 15c2-12 under the Securities Exchange Act of 1934 (the "Exchange Act").[1]

II. Background

Rule 15c2-12 generally prohibits any underwriter from purchasing or selling municipal securities unless the issuer has committed to providing continuing disclosure regarding the security and issuer, including information about its financial condition and operating data.[2] Rule 15c2-12 also generally requires that any final official statement prepared in connection with a primary offering of municipal securities contain a description of any instances in the previous five years in which the issuer failed to comply, in all material respects, with any previous commitment to provide such continuing disclosure.

The Commission may file enforcement actions under either Section 17(a) of the Securities Act of 1933 (the "Securities Act"), and/or Section 10(b) of the Exchange Act against issuers for inaccurately stating in final official statements that they have substantially complied with their prior continuing disclosure obligations. In such instances, underwriters for these bond offerings may also have violated the anti-fraud provisions to the extent they failed to exercise adequate due diligence in determining whether issuers have complied with such obligations, and as a result, failed to form a reasonable basis for believing the truthfulness of a key representation in the issuer's official statement. For instance, on July 29, 2013, the Commission charged a school district in Indiana and its underwriter with falsely stating to bond investors that the school district had been properly providing annual financial information and notices required as part of its prior bond offerings.[3] Without admitting or denying the Commission's findings, the school district and underwriter each consented to, among other things, an order to cease and desist from committing or causing any violations of Section 10(b) of the Exchange Act and Rule 10b-5. The underwriter also agreed to pay disgorgement and prejudgment interest of $279,446 as well as a penalty of $300,000.

The Commission has in the past emphasized that the likelihood that an issuer will abide by its continuing disclosure obligations is critical to any evaluation of its covenants. An underwriter's obligation to have a reasonable basis to believe that the key representations in a final official statement are true and accurate extends to an issuer's representations concerning past compliance with disclosure obligations. Indeed, this provision of Rule 15c2-12 was specifically intended to serve as an incentive for issuers to comply with their undertakings to provide disclosures in the secondary market for municipal securities, and also assists underwriters and others in assessing the reliability of the issuer's disclosure representations. Moreover, the Commission has in the past stated that it believes that it is doubtful that an underwriter could form a reasonable basis for relying on the accuracy or completeness of an issuer's ongoing disclosure representations without the underwriter affirmatively inquiring as to that filing history, and the underwriter may not rely solely on a written certification from an issuer that it

Questionnaire

Municipalities Continuing Disclosure Cooperation Initiative Questionnaire for Self-Reporting Entities

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

2. Undertakings

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

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

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

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

3. Civil Penalties

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

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

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

D. No Assurances Offered with Respect to Individual Liability

The MCDC Initiative covers only eligible issuers and underwriters. The Division provides