



# POST ISSUANCE COMPLIANCE UPDATE

Alan Bond  
Managing Director  
[abond@blxgroup.com](mailto:abond@blxgroup.com)  
(212) 506-5275

Erik Dingwall  
Managing Director  
[edingwall@blxgroup.com](mailto:edingwall@blxgroup.com)  
(813) 872-6840

BLX 

# Post-Issuance Tax Compliance Training

Alan Bond

# What Is Post-Issuance Tax Compliance



Post-issuance tax compliance begins with the debt issuance...and requires a continuing focus on investment of bond proceeds and use of bond-financed property.

After the Bonds Are Issued Then What?  
Advisory Committee on Tax-Exempt and  
Governmental Entities



## Requirements at closing of bond transaction

- Tax Form filings – 8038/8038-G
- Reasonable expectations regarding use and ownership of property

## Requirements relating to ongoing monitoring after the issuance of the bonds

- Qualified use of proceeds and bond financed property
  - Requires monitoring the various direct and indirect uses of bond financed property over the life of the bonds
  - Requires calculations of the percentage of nonqualified use
  - Ownership
- Arbitrage yield restriction and rebate
  - Requires monitoring over the life of the bonds to determine whether the yield on investments acquired with bond proceeds are properly restricted



## IRS Focus on Post-Issuance Tax Matters

- The average tax-exempt bond issue is outstanding for 25-30 years
- Issuers and conduit borrowers must comply with federal tax rules for the life of the original bonds and any refunding bonds
- Easy for foot faults and errors to occur or for borrowers to lack requisite records and detailed information to rebuff IRS in an audit challenging the tax-exempt status of bonds



Why is the IRS focused on post-issuance compliance?

- IRS is looking to ensure that the federal subsidy provided by the interest exclusion on tax-exempt bonds is properly applied
- Interest exclusion cost to federal government estimated to be approximately \$200 billion in Fiscal Years 2008-2012



Why should you care about the IRS post-issuance compliance initiative?

- Failure to comply with the federal tax requirements will jeopardize the preferential tax status of those bonds
- Defending tax-exempt status of bonds in an IRS audit is expensive, stressful, and time consuming
- Tarnish reputation in credit markets
- Financial settlement to protect bondholders can be costly

# IRS Enforcement Update



- Compliance is being monitored
- Audits - 300 to 400 issues being audited at a time
- Post-Issuance Compliance Questionnaires
- Educational sessions are being offered
- On average IRS has received \$20-\$25 million each year from abusive transactions



# Elements of an Effective Post-Issuance Compliance Program



1. Designation of tax compliance point person(s)
2. Continuing education and training for individuals responsible for post-issuance compliance
3. Tracking and allocating the expenditure of bond proceeds
4. Monitoring the investment income and arbitrage compliance restriction
- 5. Monitoring the use of bond financed property**
6. Periodic review of management contracts, other facility use agreements, and research contracts by experts in tax matters
7. Addressing changes in use of bond financed property through self-help remediation and VCAP
- 8. Recordkeeping and retention policies and procedures**
9. Periodic compliance reviews/ongoing communication with outside tax specialists
- 10. Written policy and procedures relating to post-issuance compliance**



## Evolution of IRS Written Policy Inquiry

- Compliance Check Questionnaires
- IRS Form 8038-B – new issuance of BABs (Rev Jan 2010)
- IRS Form 8038-TC – new issuance of Tax Credit Bonds (Rev June 2010)
- IRS Form 8038 – new issuance of Private Activity Bonds (Rev April 2011)
- IRS Form 8038-G – new issuance of Governmental Bonds (Rev Sept 2011)
- IRS Schedule K (for nonprofit organizations) – 2013 version has 3 separate questions
- Questions regarding written procedures have become much more explicit
- Internal Revenue Manual provides that issuers and borrowers with written post-issuance compliance policies and procedures will be given a more favorable settlement during VCAP



Do you have written policies/procedures in place?

- When implemented?
- Who is responsible?
- Are they being reviewed annually to keep them relevant

## Importance of Written Policies

- Demonstrates taking post-issuance compliance responsibilities seriously
- Assigns responsibility for certain tasks and responsibilities to specific individuals or departments
- Provides you with a compliance framework in which to work
- Memorializes processes and activities to aid in the event of staff turnover
- Reduces risk of IRS winning willful neglect case



## What should be included in a Policy?

- Designation of post-issuance tax compliance point person(s)
- Tax-exempt bond tax law compliance requirements including:
  - Documentation
  - External counsel/advisors
  - Investments/role of trustee
  - Arbitrage and yield restriction
  - Private use of bond proceeds
  - Identification and correction of violations
  - Expenditures
  - Final allocations



What should be included in a Policy? (continued)

- Record keeping requirements
- Annual review and training
- Frequency of internal compliance checks

Important to review annually and update as necessary



## What records must be maintained?

- Documents related to the bond transaction (entire transcript)
- Documents related to post-closing elections
  - Bond Year Selection
  - Retro-Active or Selective Application of Regulations
- Documents evidencing any investment of bond proceeds
  - Trust Bank Statements
  - Internal Records (expenditure detail)
- Documents evidencing expenditure of bond proceeds
- Use of bond financed property by public and private sources
- Sources of payment or security for the bonds
- Arbitrage Reporting – Rebate and Yield Restriction



## What records must be maintained? (continued)

- Section 6001 of the Internal Revenue Code requires the retention of records to support tax positions taken
- If not supported, the IRS can draw its own conclusions based upon the information presented
- Records must be maintained by:
  - Issuers
  - Conduit Borrowers
  - Bondholders



## Governmental Bond Requirements:

- Generally, at least 90% of the proceeds of the bond issue must be used for governmental purposes
- The 90% requirement is increased to 95% in certain circumstances
  - See Tax Certificate for details
- Aggregate private business use generally cannot exceed the “lesser of” 10%, 5% or \$15 million
- Costs of issuance of the bonds paid with bond proceeds are not treated as a private business use





## \$800 million governmental bond issue

Par Amount	\$800 million	\$800 million	\$800 million
Tax Code Limit	10%	5%	\$15 million
Maximum PBU	\$80 million	\$40 million	\$15 million

- Be mindful of this “lesser of” concept
- Need to consider all private use within the bond issue



## Basic Tax Analysis in Governmental Bond Financings

- Are the bond financed assets used by members of the general public?
- Does a party other than a State or Local Government agency or department have a “special legal entitlement” to use the bond financed assets?
- Private business use can arise under a management contract even if the assets serve the general public
- Use of bond financed assets by a charitable organization (e.g., a Section 501(c)(3) organization) will generally give rise to private business use
- Contracts with the federal government will generally give rise to private business use



Contracts that may give rise to private business use include:

- Management Contracts
  - Food Service Contracts
  - Concession Contracts
  - Cafeteria Contracts
  - “Out-sourcing” certain activities



Contracts that will generally give rise to private business use:

- Leases

- Cafeteria Contracts
- Office Spaces
- Corporate Events
- Solar Panels
- Cell Phone Antennas



- Many so-called “management contracts” are in fact leases (even though it might be called something else)
- If someone is paying you rent (\$) or splitting net profits (\$) from an operation in bond financed space they are generally treated as lessee under the tax rules



## Why do Some Management Contracts Give Rise to Private Business Use?

- They represent a transfer of control or economic benefit from the owner to a private party
- They provide a “special legal entitlement” to use bond financed property



## Safe Harbors - Management Contract Guidelines

- Provides framework for contracts with non-employees/outside providers for various services involving the use of bond financed property
- Contracts with non-employees
  - Professional corporations
  - Cafeteria operations
  - Outsourcing of certain operations to third parties



- **Prior IRS Guidance - Revenue Procedure 97-13 and IRS Notice 2014-67**
  - Based on mechanical rules
  - Provides for range of contract structures based on term and compensation
  - The longer the term, a higher percentage of the compensation needs to be fixed
    - 15 year term
    - 10 year term
    - 5 year term
    - 3 year term
    - 2 year term



# Private Use Exceptions



- **Revenue Procedure 2016-44** -- released August 22, 2016
  - Replaced mechanical approach of Rev Proc 97-13 with a principle-based approach (now superseded)
- **Revenue Procedure 2017-13** -- released January 17, 2017
  - Supersedes Rev Proc 2016-44
  - Addresses concerns raised by Rev Proc 2016-44, most notably confirming that certain Rev Proc 97-13 compliant contracts will not cause private business use under the new rules
  - Applies to contracts entered into on or after January 17, 2017
- **Revenue Procedure 97-13 Lives!!** – still may be applied to contracts entered into before August 18, 2017



- **Rev Proc 2017-13**

- Applies principle-based concepts of control, risk, and who derives the benefits and burdens of bond-financed property
- This approach requires more legal analysis and judgement, and increases the risk of differing IRS interpretation



- **Rev Proc 2017-13**

1. Compensation must be reasonable
2. Timing and payment of compensation
3. Service provider may not receive a share of net profits from managed property
4. No bearing of net loss to the manager
5. Term of the contract
6. Control over the use of managed property
7. No risk of loss to the manager
8. No inconsistent tax positions
9. Owner's exercise of rights



## Short term use exceptions:

- In certain circumstances, if < 100 days of use
- In certain circumstances, if < 50 days of use
  - Depends on user profile and terms of contract



## Incidental Contracts or Arrangements

- Small physical use of space
  - ATM, kiosks, vending machines, laundry facilities
  - Cannot exceed 2.5% of proceeds or space of facility
- Contract for services supporting organization activities
  - Janitorial services
  - Equipment repair
  - Billing activities or similar services



## Fundamentals

- Identify property financed by each issue of outstanding bonds
- Was the original bond issue refunded? If so, by what bond issue?
- Who uses that space?
- How much space are they using and for how long?
- Is there any private use?
- Did you “allocate” equity to any portion of the facility?
- What records support the allocation of bond proceeds and/or equity to that facility?



## 4 Primary Methods

- Square footage
- Time of use
- Time/space analysis
- Revenues

Under the applicable tax regulations, the measurement of private use must be reasonable. Determining what method is most appropriate may require professional judgment.

# How to Measure Private Use



Private use identified at the time of issuance of the bonds

- Step 1: Quantify the expected private use
- Contribute equity or other amounts to projects to cover private use





Monitoring private use after the bonds are issued:

- Step 1: Review use of bond-financed projects and applicable third party agreements annually
- Step 2: Calculate private use per bond issue
  - Establish that less than 10% of bond proceeds are privately used
  - For the entire period that the bonds are outstanding



Remedial actions include:

- Defeasance of a portion of the bonds
- Using the disposition proceeds from the sale of the bond financed asset for another qualified purpose
- VCAP – Voluntary Closing Agreement Program

# Benefits of an Effective Post-Issuance Compliance Program



- Remove risk of non-compliance and associated hazards
- Generate efficient and prompt response to any IRS inquiry
- Easy and cost-effective review process at time of refunding
- Identify remaining portion of bond proceeds allowed for private use
- Provide historic analysis of post-issuance compliance for outstanding tax-exempt debt
- Memorialize institutional memory in cases of staff turnover

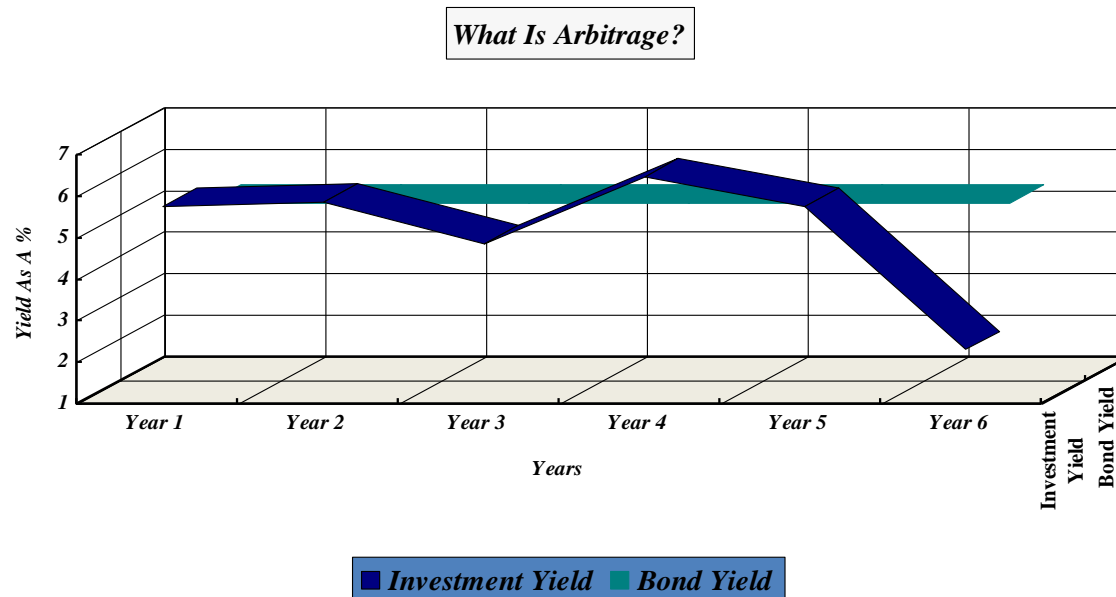
# Fundamentals of Arbitrage Compliance

Erik Dingwall



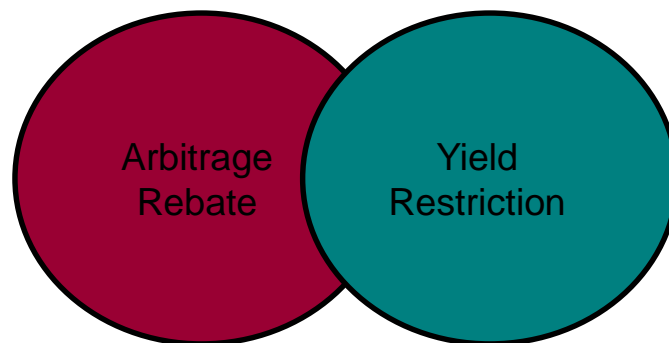
- Arbitrage Defined

- Borrow at tax-exempt rates and invest at higher taxable rates without incurring any additional risk (disparity between markets)





- Arbitrage Requirements - 2 separate requirements though related
  - Need to comply with both requirements to avoid bonds being declared “Arbitrage Bonds”



- Arbitrage rebate – issuers can achieve compliance by remitting a rebate payment to the IRS
- Yield restriction – issuers can achieve compliance by...
  - Investing yield restricted amounts at a yield below the bond yield or...
  - Remitting a yield reduction payment to the IRS



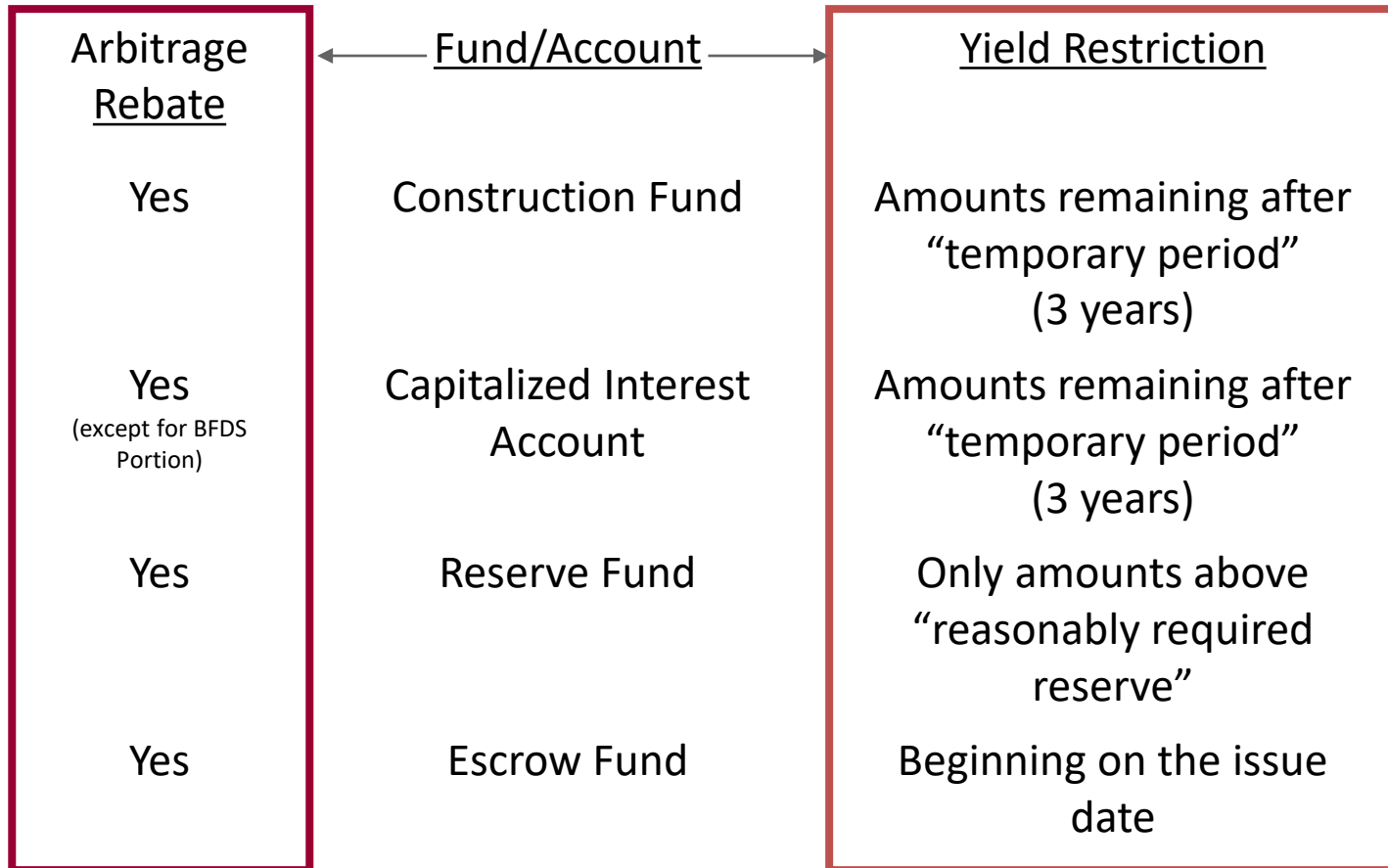
## Arbitrage Rebate

- Gross proceeds
  - Sale proceeds – amounts received from the sale of the bonds
  - Investment proceeds – earnings on sale proceeds
  - Replacement proceeds – typically amounts pledged to pay debt service
  - Transferred proceeds – prior bond proceeds that become proceeds of the refunding bonds

## Yield Restriction

- Amounts remaining beyond applicable “temporary period” (usually 3 years)
- Amounts beyond the “reasonably required reserve”, minimum of ...
  - 10% of par amount
  - 125% of average annual debt service
  - Maximum annual debt service
- Advance refunding escrows
- Transferred proceeds

# Amounts Subject to the Requirements



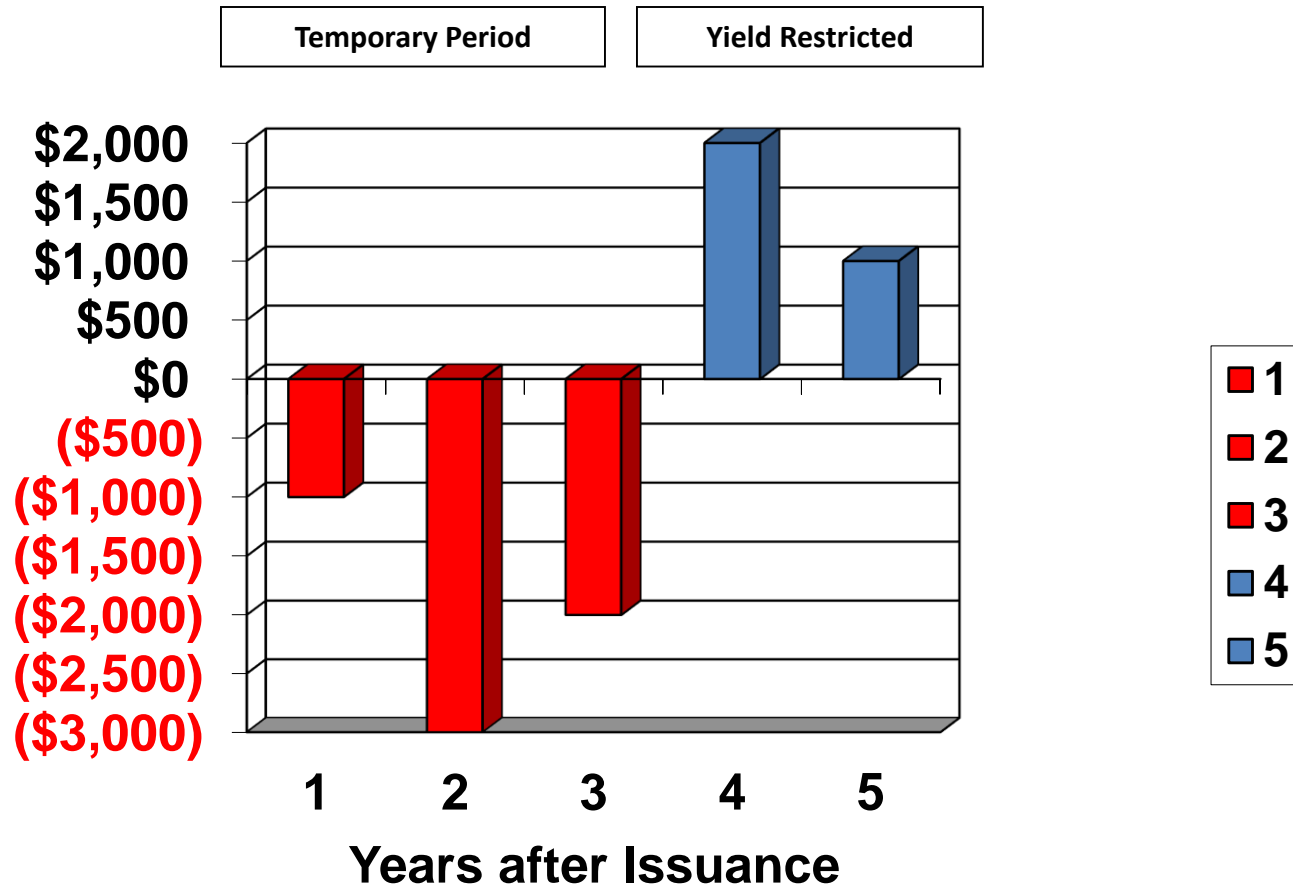


# Arbitrage Rebate Payments vs. Yield Reduction Payments



- Can owe yield reduction payment without owing rebate payment
  - Even though your issue met an exception to the REBATE requirement, it is still subject to the YIELD RESTRICTION requirement
    - Small issuer exception – most common source of error

# Arbitrage Rebate Payments vs. Yield Reduction Payments



# Arbitrage Rebate Payments vs. Yield Reduction Payments



- Arbitrage rebate and yield reduction payments are both required to be paid no later than 60 days after each “5th Bond Year” and 60 days after the final redemption date
  - Payments made after 60 days need to include late interest on underpayment. Late interest rates are high, and change quarterly. Making a late payment is better than making no payment at all (willful neglect will cost you a 50% penalty in addition to late interest if it can be proven)
- 90% payment due at each installment computation date
- 100% payment (or remaining 10%) due at final maturity/redemption date



- Spending Exceptions

- All or a portion of the bond proceeds may be excluded from the arbitrage rebate requirements if they meet a spending exception
- If you earned positive arbitrage and met an exception you are allowed to keep the excess earnings on that portion of proceeds that qualified for the exception
- Not mandatory if you met the exception. If you met the exception but earned negative arbitrage, you may want to use that negative arbitrage to net against positive arbitrage earned in other funds
- If a prior issue with proceeds eligible for and on track to meet an exception is refunded, those proceeds are still eligible to meet the exception even though they would otherwise have become transferred proceeds of the refunding issue. If they meet the exception they are not subject to rebate under either issue



- Spending Exceptions - continued
  - 6 month spending exception
    - Gross proceeds need to be spent within 6 months
    - Gross proceeds do not include amounts deposited in the Reserve Fund
    - Gross proceeds do not include amounts invested in the bona fide Debt Service Fund
    - 6 month spend down period can be extended for an additional 6 months if unspent proceeds equal the lesser of 5% of gross proceeds or \$100,000
    - Only exception available to refunding bonds
      - ✓ Transferred proceeds from the refunded issue do not necessarily need to be spent within 6 months for the refunding issue to meet the requirements of the exception



- Spending Exceptions - continued
  - 18 month spending exception
    - Spending requirements
      - ✓ 15% in 6 months
      - ✓ 60% in 12 months
      - ✓ 100% in 18 months
    - Gross proceeds do not include amounts deposited in a reasonably required reserve fund
    - Gross proceeds do not include amounts invested in a bona fide debt service fund
    - Estimated earnings on gross proceeds to be used during first two spending periods, actual earnings used during last spending period
    - Gross proceeds must qualify for a 3 year temporary period



- Spending Exceptions - continued
  - 18 month spending exception - continued
    - No portion of an issue can qualify for the 18-month exception if another portion of the same issue has met the rebate requirement under the 2-year exception
    - De Minimis Rule – Any failure to satisfy the final spending requirement of the 18-month exception or the 2-year exception is disregarded if the issuer exercises due diligence to complete the project financed and the amount of the failure does not exceed the lesser of 3 percent of the issue price of the issue or \$250,000
    - Extension for reasonable retainage – an issue does not fail the spending requirement for the final spending period if the failure is a result of reasonable retainage, if the reasonable retainage is allocated to expenditures within 30 months of the issue date. Reasonable retainage is 5% of gross proceeds



- Spending Exceptions - continued
  - 2-year exception
    - Applies to “construction” issues only
    - Only includes “Available Construction Proceeds” (hereinafter ACP)
      - ✓ Construction Fund and earnings thereon
      - ✓ Capitalized Interest Account and earnings thereon
      - ✓ Reserve Fund earnings (can be excluded by election on or before issue date)
      - ✓ Costs of Issuance earnings
        - Only need to spend earnings, but if all costs of issuance spent prior to 2 year date, any excess earnings on sale proceeds used for costs of issuance excepted from rebate
    - ✓ Reasonable expectations test for future earnings – calculated as of the issue date for all components of ACP and used for first 3 spending periods. You can elect to use actual facts for first 3 periods. Actual facts used for final spending period





- Spending Exceptions - continued
  - 2 - year exception - continued
    - Spending requirements
      - ✓ 10% in 6 months
      - ✓ 45% in 12 months
      - ✓ 75% in 18 months
      - ✓ 100% in 24 months
  - Reasonable retainage allowance
  - De minimis rule applies



- **Small Issuer Exception**
  - \$5,000,000 per calendar year limitation (subordinate entity debt included)
  - School Districts – raised to \$10,000,000 for 1998 to 2001, and \$15,000,000 in 2002 to present
    - ✓ Caveat: no more than \$5,000,000 can be used for non-construction purposes
  - Private activity bonds – not eligible
- **Bona Fide Debt Service Fund Exception**
  - \$100,000 earnings test per bond year
    - ✓ Variable rate bonds
    - ✓ Private activity bonds
    - ✓ Short term bonds (WAM < 5 years)

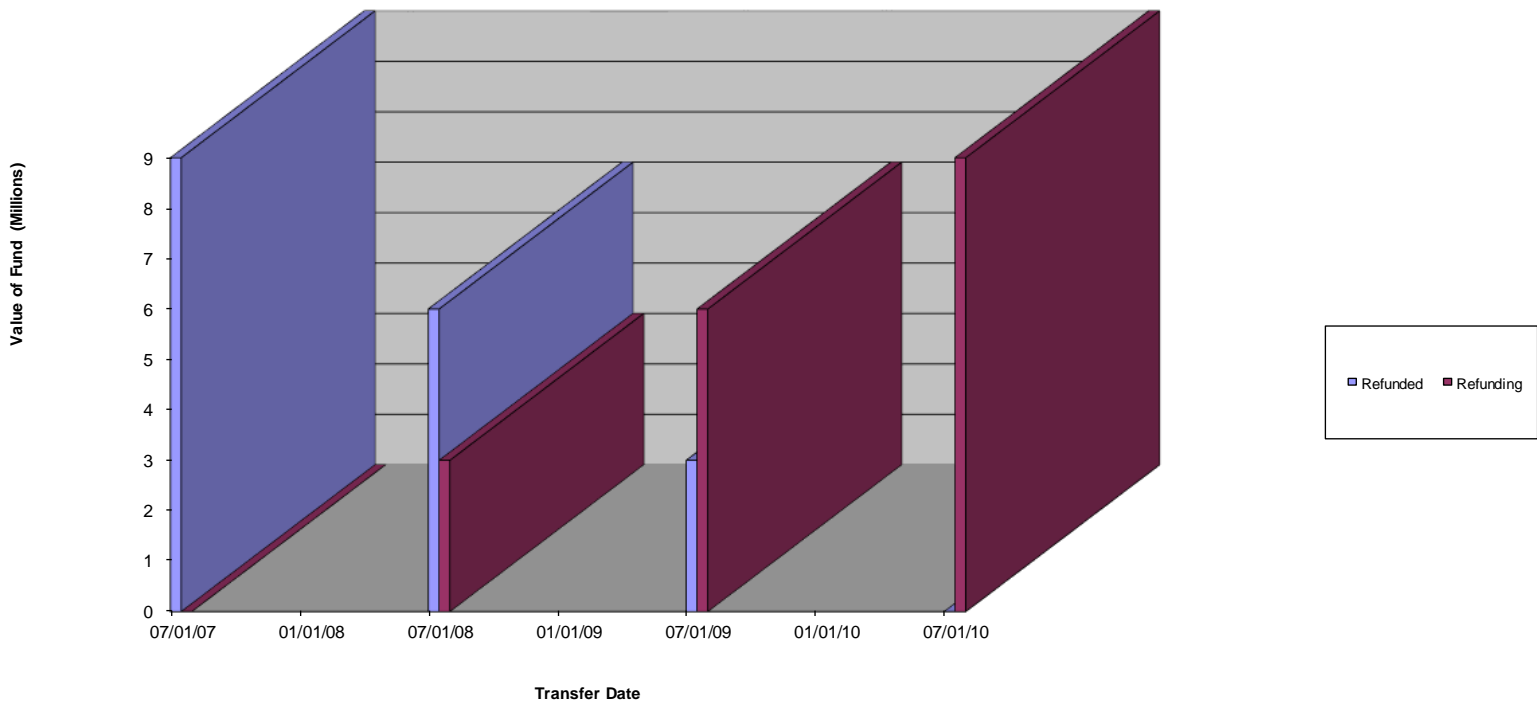


- Transferred Proceeds Considerations
  - Transferred Proceeds arise when proceeds of a refunding issue are used to redeem principal of a refunded issue and there are unexpended gross proceeds of the refunded issue
  - On each date that refunding proceeds are used to redeem principal of the refunded issue, a ratable portion of the gross proceeds of the refunded issue still outstanding will become allocable to the refunding issue on that date
  - Proceeds can only be gross proceeds of one issue at a time, so the proceeds that transfer from the refunded issue to the refunding issue will be subject to arbitrage at the arbitrage yield of the refunding issue once they transfer
  - Transferred Proceeds are Yield Restricted starting with the date of transfer

# Defeasance vs. Redemption



Transferred Proceeds Example: Transfer of Construction Fund  
(one third of outstanding principal redeemed every 6 months)



Issue date of refunding bonds is 7/1/07



- Reinvest rates may be higher next year and in the future
- Yield Restriction trap
  - Potential strategy: yield restrict all proceeds from issue date
- Really strategy shouldn't change
  - Earn what is appropriate given the circumstances and pay what you owe
  - Appropriate duration of investments
  - Liquidity portion as necessary
  - Hold to maturity unless segment pricing inefficiencies offer opportunities to sell prior to maturity

# IRS Final Arbitrage Regs



- Published in Federal Register 7/18/2016
  - Proposed regs from 2007 and 2013
  - Issue price regs not finalized
- Changes made to the following areas of the regs:
  - Working Capital financings
  - Rebate computation date credit
  - Refund requests
  - Swaps/Hedges
    - Integration with bond yield
    - Modifications and Termination
  - Yield Reduction payments
    - SLGS Window closed
  - Valuation of Investments
  - Small Issuer Exception
  - Treatment of Grants
- Effective for Bonds sold on or after 10/17/2016
- Some elections (e.g. comp date credit) can be elected prior to effective date

# Municipal Continuing Disclosure & Recent SEC Settlement Actions

Erik Dingwall



## Release No. 34-34961

- “... to deter fraud and manipulation in the municipal securities market by prohibiting the underwriting and subsequent recommendation of securities for which adequate information is not available.”
- “... ensure that brokers, dealers, and municipal securities dealers will review the secondary market disclosure practices of issuers and other obligated persons at the time of an offering of municipal securities. This scrutiny at the time of initial issuance of municipal securities will result in the dissemination of important information by issuers and other obligated persons throughout the term of the municipal securities. As a result of the amendments, brokers, dealers and municipal securities dealers will be better able to satisfy their obligation under federal securities law to have a reasonable basis on which to recommend municipal securities,....”





## **SEC Rule 15c2-12 (July 1995)**

- Includes the annual reporting of financial and operating data and certain event disclosures relating to an issuer/obligated person
- Rule applies directly to underwriters (broker/dealers)
- Rule applies indirectly to issuers/obligated persons
- Prior to acting as underwriter in a primary offering, underwriter must have a reasonable basis that an issuer has undertaken, in writing, to provide certain information on an annual basis to bondholders (“Continuing Disclosure Agreement” or “CDA”)
- Without commitment, underwriter cannot participant in the purchasing or selling of such municipal securities



## Failure of Issuer to comply with CDA

- Breach of contract (though not an event of default under bond resolutions)
- Must disclose such failure in future Official Statements for the period of 5 years following the failure
- Suits or remedies may be brought by bondholders who claim they would have not bought, sold or held the security had the information been provided when agreed
- Misleading or omitted information may lead to securities fraud
- Including only the information specifically required under the continuing disclosure agreement may not be deemed sufficient to satisfy the requirement and could result in securities fraud under Rule 10b-5



- In August 2010 in Release No. 34-62184A, the SEC clarified and reinforced its view of the obligation of an underwriter to consider the obligated person's record of compliance with prior continuing disclosure undertakings when recommending a security
- The SEC has made it clear that the underwriter cannot rely solely on representations by an issuer or obligated person as to its compliance with continuing disclosure
- The underwriter must conduct its own investigation and make an independent judgment concerning the issuer's compliance (look back is 5 years)
- Failures discovered by the underwriter may be disclosed in the official statement for the security
- Failures in compliance may result in issuer establishing written policies assigning key personnel or retention of an outside consultant to assist in the preparation of annual reports and event notices

# MCDC (S.E.C. Self-Reporting Initiative)



- In March 2014, SEC established the Municipal Continuing Disclosure Cooperation Initiative (“MCDC”)
- Voluntary program designed for underwriters and issuer/obligors to “self-report” instance of “material” inaccurate statements in final OS’s regarding an issuer/obligors historical continuing disclosure compliance
- Self-Reporting available until September 10, 2014 for underwriters and December 1, 2014 for Issuers/Obligors
- Settlement terms under the MCDC program were provided
- SEC indicated that if it found material misstatements that were not reported, sanctions would be more severe



- Underwriters and issuers/obligors performed thorough reviews of OS's to determine if material misstatements were made
- Each underwriter established its own criteria for self-reporting transactions
  - number of days late
  - event notices (insurer rating changes, defeasances, etc.)
  - availability of disclosure (NRMSIRs, EMMA, CUSIPs, etc)
- Issuers performed review and had the benefit of knowing whether the underwriter self-reported their transaction



- Settlement Terms for Underwriters
  - consent to “cease and desist” proceedings
  - retain an independent consultant (“IC”) to conduct a due diligence review of process and procedures and provide recommendations within 180 days
  - enact IC recommendations within 90 days
  - cooperate with any SEC investigation, including roles of individuals/other parties
  - provide compliance certification to SEC within one (1) year
  - CIVIL PENALTIES – between \$20K-\$60K per violation, \$500,000 cap



- Settlement Terms for Issuers/Obligors
  - consent to “cease and desist” proceedings
  - establish policies and procedures and training regarding continuing disclosure within 180 days
  - correcting past delinquent filings within 180 days
  - disclose the settlement terms in future official statements over the next five (5) years
  - provide compliance certification to SEC within one (1) year
  - cooperate with any SEC investigation, including roles of individuals/other parties
  - NO CIVIL PENALTY

**MCDC PROVIDES NO PROTECTION FOR INDIVIDUALS**



## UNDERWRITER SETTLEMENTS

- On June 18, 2015, SEC announced the first wave of underwriter settlements under the MCDC Initiative
  - 36 Underwriters
  - \$9.3 Million in civil penalties
- On September 30, 2015, SEC announced the second wave of underwriter settlements under the MCDC Initiative
  - 22 Underwriters
  - \$4.12 Million in civil penalties
- On February 2, 2016, SEC announced the third and final wave of underwriter settlements under the MCDC Initiative
  - 14 Underwriters
  - \$4.58 Million in civil penalties
- In total, 72 Underwriters and over \$18 million in penalties
- A description of the material failure was provided





## UNDERWRITER SETTLEMENTS (cont.)

- Number of failures discussed reflected the number of transactions to reach settlement amount
- Transactions discussed in the order did not identify the issuer of the subject bonds
- Negotiated and competitive deals included
- Material Items Discussed
  - late and missing filings, including missing operating data (even though audit was provided)
  - failure to file “notice of failure to file on time”
  - instances in which an OS included the information and was available by the deadline but the issuer had not provided on EMMA a cross-reference to the OS
  - late quarterly filings (not required under Rule 15c2-12)
  - instance of failure to file advance refunding and associated redemption notices (though included other failures)
  - disclosure was not accurate (some missing filings not discussed)



## **UNDERWRITER SETTLEMENTS (cont.)**

- The settled orders cited 1-3 examples of improper disclosure (anonymous)
- The settled orders cited examples that reflected the range of conduct that was submitted to the SEC
- SEC indicated that the examples were designed to provide a broad guidance to the market (unlike the Kings Canyon USD settlement which was vague)
- SEC further stated that each example bullet point in each order is considered material, but that if multiple events were mentioned, only the cumulative action mentioned in the bullet point should be considered material



## ISSUER SETTLEMENTS

- On August 24, 2016, SEC announced the first settlements (since Kings Canyon USD) under the MCDC Initiative for Issuers/Obligors since the filing deadline past
  - 71 Issuers (included 2 states, 7 state authorities, 29 local agencies, 9 schools, 6 universities, 5 healthcare, 5 utilities, 1 retirement community, and others)
  - Across 45 states
  - \$0 in civil penalties
- Material Items Discussed
  - late and missing filings
  - failure to file “notice of failure file on time”
  - statements made in OS that did not reflect all failures
  - Failures discovered when OS was silent
  - failure to file “defeasance” notice



## REASON FOR MCDC

- SEC Rule 15c2-12 was designed to make available current market information for investor and improve trading in the secondary market
- SEC aware of lack of continuing disclosure compliance
- A number of SEC enforcement actions occurred prior to MCDC
- Inaccurate statements in official statements regarding continuing disclosure compliance could also lead to inaccurate statements regarding other information contained in the official statements

## WHAT HAS COME FROM MCDC

- Revealed that many official statements falsely stated that the issuer was in full compliance, including deals as late as 2014
- Much greater awareness of the importance of continuing disclosure
- Sound policies and procedures developed
- Improved underwriter due diligence in primary offerings
- Careful attention to future continuing disclosure filings
- Increase in continuing disclosure filings



## Sample SEC enforcement actions

- Mislead investors with respect to information relating to pensions
- Making materially misleading statements outside of disclosure documents
- Inaccurate statements regarding the review of financial information
- Making false statements about continuing disclosure to bond investors in an official statement
- Municipal issuer violating an existing cease and desist order



## Why?

- Shows organization cares about compliance
- Shows organization is actively managing its compliance
- May be a mitigating factor when SEC calls
- May lessens the risk for personal liability for staff if policies are followed
- Greater attention to disclosures made for continuing disclosure compliance and for new offerings

# Establishing Policy and Procedures



- Establish internal written procedures to comply with Continuing Disclosure Agreements (“CDA”)
- Identify key personnel and their responsibilities for CDA compliance
  - Disclosure Team
    - review annual reports and event notices
    - review historical compliance with CDA undertakings
  - Coordinator (point person)
    - monitor compliance
    - information gathering
    - communication with third parties
    - training
- Internal Communication is Key
  - communication between those who become aware of the material events and those who file the event notices must be established and maintained
- Make your CDA required reading for any new employees that will be involved in providing information for continuing disclosure purposes



- Create a template/chart for annual compliance and event notices to be reported
- Review each CDA and identify the following:

## For Annual / Quarterly Reports

- what information is required to be included in the annual/quarterly reports
- when are annual/quarterly reports due
- what information will need to be obtained from third parties
- who should receive copies of the annual/quarterly reports (EMMA, insurer's, underwriter's, rating agencies, etc.)

## For Event Notices

- what are the SEC listed events
- when are listed events due
- who is responsible for identifying when a listed event has occurred
- defeasance, bond call, and rating changes are the most common events, especially when a refunding occurs



# Establishing Policy and Procedures



- For Voluntary Notices
  - discuss with counsel – determine materiality
  - carefully review the notice before submitting to EMMA
- Internal Tickler System
  - establish an internal tickler system for reporting due dates
  - utilize EMMA automated tickler system of approaching deadlines
  - third-party consultants
- Annual Reports
  - consider providing a “roadmap” or “cross-reference” of where the required information is contained in the disclosure filing (Audit, CAFR, OS, etc.)



- CDA is your Responsibility!
  - after submitting your disclosure documents to the dissemination agent, check to make sure the disclosure documents appear on EMMA
  - request / retain EMMA confirmations as evidence of compliance
  - if an OS represents your annual report, provide a notice indicating such and make sure the OS is available on EMMA by the required due date
  - EMMA is a “submitter-based” platform so make sure description of the disclosure documents is accurately reflected
  - if the annual/quarterly reports provide cross-reference to other documents (i.e. audits, budgets, etc), make sure such other documents are also available on EMMA
  - if you cannot file your annual report on time, file the “notice of failure to file on time” on or before the required due date
  - remedy missing disclosures as soon as practicable

# Continuing Disclosure Agreements



- Future Continuing Disclosure Agreements
  - make it easy to comply
  - make it easy for third party to determine if you've complied
  - avoid using “X” number of days after fiscal year
  - choose a date that you can comply with
  - discuss “content” with underwriter prior to executing CDA
  - what information is important for future investors to trade the bonds
  - are you able to provide such information for the life of the bonds (30 years)
  - consider availability of information from third-party sources
  - consider attaching a “template” of the report in the CDA
  - if there are multiple obligated persons, clearly identify each party's obligations
  - quarterly reporting not required under Rule 15c2-12 - consider using the “loan agreement” as vehicle to provide quarterly reporting



- Events that require notification within ten (10) business days:
  - Principal and interest payment delinquencies
  - Unscheduled draws on reserve
  - Unscheduled draws on credit enhancement
  - Substitution of credit or liquidity provider or failure to perform
  - Adverse tax opinion, the issuance by the IRS of proposed or final determination of taxability, adverse tax opinions, or Notices of Proposed Issue (IRS Form 5701-TEB)
  - Defeasances
  - Rating changes
  - **Tender offers**
  - **Bankruptcy, insolvency, receivership, or similar event of an obligated person**



- Events that require notification, if material:
  - Nonpayment related defaults
  - Modification to bondholder rights
  - Optional, contingent or unscheduled bond calls
  - Release, substitution or sale of property securing repayment of bonds
  - **Merger, consolidation, acquisition, or sale of all or substantially all of the assets of an obligated person, other than in the ordinary course of business, and the entry into or termination of an agreement to undertake such action**
  - **Appointment of a successor trustee or change in name of a trustee**

# Issuer Considerations



- Criteria established by underwriters
- Potential secondary market impacts
- Dissemination Agent vs. Disclosure Consultant
- Registered Municipal Advisor?