ATTACHMENT 3

Considerations for Underwriters

1. It is clear that continuing disclosure compliance is (and has been for a while) high on the agenda of the SEC and FINRA. Every underwriter in the industry is a potential candidate for the MCDC Initiative. For the reasons spelled out below, every underwriter should take the opportunity to do a thorough review of the past compliance of the issuers whose bonds have been underwritten during the past five years. Note that the MCDC Initiative covers both negotiated and competitive underwritings.

2. The incentives embedded in the MCDC Initiative weigh heavily on the side of doing a thorough review and self-reporting as wide a list of potential disclosure failures as reasonable.

a. Particularly for larger firms which have done hundreds or thousands of issues over the past five years, the predetermined penalty is tiny compared to the alternative. Recall that City Securities was fined $300,000 in connection with its due diligence failure on just one bond issue (although it should be noted that the SEC's Order did contain findings of other misconduct). Under the MCDC Initiative, the maximum total civil fine is $500,000 for an unlimited number of potential violations reported. The SEC has made clear that an underwriter likely will pay a larger financial penalty for unreported due diligence violations.

b. An underwriter should self-report everything in one submission. The SEC staff at the Boston conference made it clear that if an underwriter made a partial report (say, 25 issues at $20,000 fine per issue, total of $500,000 maximum fine), but the SEC learned that the underwriter participated in other issues (because of self-reports from issuers or its own investigations) not included in the submission, the SEC would seek to impose harsher penalties notwithstanding the partial self-report.[6] Clearly, the SEC is looking for the underwriting community to do its homework for it, and is putting the incentives entirely in favor of having the underwriters report on virtually all instances of noncompliance of which they become aware.

c. Since the maximum civil penalty is set, there is no disincentive to making reports on even minor lapses identified in the review. (Hopefully, some guidance or practice may develop allowing issuers and underwriters to forego reporting truly minor lapses.) As noted, the underwriter can then argue that some or all of the reported instances of noncompliance were actually not material. If the SEC agrees, all the better, but even if it does not, the underwriter is protected by the maximum penalty cap.

d. Unlike issuers, underwriters are directly regulated by the SEC and FINRA, so failing to take advantage of the MCDC Initiative could expose an underwriter to additional regulatory problems, especially if they are caught up by a report from an issuer. FINRA has not announced any coordinated process with the MCDC Initiative, but it is unlikely to deal harshly with an underwriter or its staff which cooperates with the SEC. This said, if the SEC uncovers evidence of misconduct beyond the continuing disclosure due diligence failures, such as was the case with City Securities, additional sanctions may be forthcoming against the firm. Moreover, as discussed above, individuals are not covered under the MCDC.[7]

3. The task facing an underwriter is admittedly daunting, particularly in light of the limited time to compile the information and file the Questionnaire. The SEC staff suggested that if a large firm really felt it couldn't complete the task before September 10, 2014, they might discuss the situation informally with staff. One solution might be to file a report by September 10 with as much information as the firm already has, and then complete the reporting afterward as part of the firm's obligation under the MCDC Initiative to cooperate with the SEC in additional investigations. It is possible that if there is a lot of complaint about the timeframe, the SEC could extend the deadline, but there has been no discussion of this yet. Another approach which a firm could take, but with some risk, is to "triage" the review and focus on a smaller subset of issues and issuers. One possibility might be to just focus on annual reports, since that would seem to be the SEC's highest priority, as evidenced in the West Clark Community Schools case. Another approach could be to focus on smaller, less frequent issuers. Another point is to look at the issuers who have had some continuing disclosure lapses which the underwriter has already identified through its increased diligence procedures during the past two-three years, and then look at the prior history of those issuers (i.e. official statements used prior to the cases where some lapses were identified). If the lapses already identified by the underwriter are potentially material, they can now be reported through the MCDC Initiative. Underwriters can also seek to contact their prior clients and ask if the issuer has become aware of its own failure to comply.

4. Underwriters should review their due diligence procedures and policies, and refresh or strengthen them if needed. Any action in mitigation may help in settlement discussions with the SEC after a self-report is filed. (The Questionnaire has a section which in effect asks for mitigating factors to be presented.)

5. Underwriters must, of course, tread carefully in terms of the relationship with their issuer clients. It would not be good practice to place a client into the "prisoner's dilemma" without forewarning, and perhaps some counseling on the MCDC Initiative if the issuer is not aware of it.

[6] One attorney at the Boston conference who represents underwriting firms asked if a firm could take the position that there surely were a lot of instances of questionable compliance, so can it just send in a $500,000 check? The SEC staff emphatically said, "no." The SEC clearly wants underwriters to provide it with chapter and verse on which issuers were noncompliant.

[7] In City Securities, the SEC also brought an action against a senior executive of the firm, who was personally sanctioned for aiding and abetting the firm's violations of securities laws and rules. He was barred from the securities industry for one year, permanently barred from being a supervisor, and had to pay a civil penalty of over $18,000, plus other monetary sanctions.