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## What Will A Continuing-Disclosure Settlement Mean For Muni Credit?

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# What Will A Continuing-Disclosure Settlement Mean For Muni Credit?

The Securities and Exchange Commission (SEC) is expected to soon start releasing Municipal Continuing Disclosure Cooperation (MCDC) initiative settlements with governmental entities. The MCDC initiative was offered to issuers and underwriters of municipal debt during a defined period in 2014 as a voluntary way to notify the SEC of potential continuing disclosure violations, in exchange for pre-defined settlements. The violations are related to SEC rule 15c2-12. (More background on the MCDC initiative is available on the SEC's website, [www.sec.gov](http://www.sec.gov).)

As settlements are announced we expect to consider the potential credit implications of each on a case-by-case basis. Disclosure practices are an important part of our assessment of management, but we do not expect the settlements themselves to translate into rating downgrades if settling issuers respond with proactive approaches to addressing any identified deficiencies in their disclosure practices. Our expectation is that there would be very limited credit impact as ratings determinations would still come down to the individual credit fundamentals.

## The MCDC Initiative

The MCDC initiative encouraged issuers and underwriters to report in 2014 violations of 15c2-12 which had occurred over the prior five years. The SEC offered the MCDC initiative as it believed that there were "potentially widespread violations" and that the general attitude toward adherence to the disclosure rules needed to be heightened throughout the market. The SEC has not revealed who self-reported.

## Types Of Settlements

### Underwriters

The SEC's enforcement division was charged with reviewing each case reported in the MCDC initiative. It has so far made public settlements entered into with underwriters and is now expected to start releasing settlements with issuers. The underwriter settlements did not require the underwriters to admit or deny any findings, but along with other provisions the underwriters would need to hire an independent consultant (approved by the SEC) to review internal practices and then implement any recommendations to further enhance compliance with 15c2-12. The underwriter settlements to date have included civil penalties, referred to as fines by those who have paid. The MCDC initiative included a maximum fine of up to \$500,000 for the largest underwriters, and there have been 72 firms paying various-sized civil penalty fines to date. The fines have ranged from \$40,000 to the maximum, according to the SEC.

### Issuers

As the SEC actions are shifting to the issuer, we expect settlements to address disclosure violations in a different way. The primary difference, per the MCDC guidelines, is that the issuer settlements will not come with civil penalty fines. According to the SEC's standardized settlement terms, the focus of the issuer settlements will be on establishing management practices within the municipal issuer to ensure remediation of past violations and to avoid future violations.

## **Increased 15c2-12 Compliance Expected**

The increased focus by the underwriter on compliance requirements and improved issuer filings per the 15c2-12 rules is expected to improve overall disclosure practices and enhance the quality and quantity of information available to the marketplace. We believe increased transparency is important in order to track and analyze credits, particularly those that do not come to market frequently. Notwithstanding the credit impact of individual settlements, we view the MCDC initiative as positive for the muni market, but we do not believe the initiative, in and of itself, is likely to result in changes to any current credit ratings.

## **Materiality Or Malfeasance**

Even though the settlements are related to SEC securities law (albeit without admitting any violations), they are unlikely in our view to trigger any immediate rating actions. In our analysis of credit, we assess disclosure issues relative to their materiality to credit. Thus, we anticipate looking at each case on its own, taking into consideration the materiality of the violation in relation to the rating, based on the applicable rating criteria. That said, should the violation be malfeasance, then there could be a more immediate impact on the rating.

## **Assessment Of Management**

We anticipate that, in general, the major credit consideration relating to the MCDC initiative will be around the capabilities of the management team. Management is an important component of our rating criteria in each sector of U.S. public finance. However, we note that management is only one input to the total rating, which underscores why we don't expect significant rating volatility if there are disclosure deficiencies identified, all other factors being equal. Management's plan, however, to remediate any violations would be an important component of our analysis of the capabilities of the management team.

Only a rating committee may determine a rating action and this report does not constitute a rating action.

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