



## POST-ISSUANCE COMPLIANCE POLICIES AND CONSIDERATIONS

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**Brian Lanser**  
 Quarles & Brady LLP  
 (414) 277-5775  
 brian.lanser@quarles.com



<p style="text-align: center;"> <b>Ed Barnicle</b>          PMA Securities, Inc.          (414) 225-0099          ebarnicle@pmanetwork.com       </p>	<p style="text-align: center;"> <b>Sara Schnoor</b>          PMA Securities, Inc.          (414) 225-0099          sschnoor@pmanetwork.com       </p>
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### *Quarles & Brady's Bond and Disclosure Counsel Practice*

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- Q&B has rendered opinions on municipal financings for nearly 70 years. The firm has served as bond counsel, underwriter's counsel, disclosure counsel, tax counsel, issuer's counsel and special counsel on state and local financings. In 2015, the firm ranked 27<sup>th</sup> in long term issues and 24<sup>th</sup> in short term issues nationally; and 1<sup>st</sup> in Wisconsin by a wide margin (based on the principal amount of the issues) for those reported to and tabulated by The Bond Buyer.
- Since 2014, Q&B served as bond counsel on over 1,550 transactions with an aggregate par amount of over \$10.1 billion
- Since 2014, Q&B has served as disclosure counsel in Wisconsin on over 650 transactions with an aggregate par amount of over \$7.2 billion
- For more information on Q&B's public finance practice, please visit our website [www.quarles.com](http://www.quarles.com) or give us a call

## *PMA's Financial Advisory, Dissemination Agent, and Bond Proceeds Management Services*

- PMA has been serving local governments for over 30 years
- PMA provides Financial Advisory services for public entities across Wisconsin
- PMA serves as Dissemination Agent for nearly all of our Financial Advisory clients. PMA does not charge for this annual service.
- PMA has provided Bond Proceeds Management services to over 120 public entities over the past 15 years, tracking compliance with arbitrage and spend down requirements.
- PMA reporting has proved instrumental for issuers that have been subjected to IRS audits.



## *Session Objectives*

- Gain a better understanding of your post-issuance responsibilities and how to manage them
  - State Law
  - Federal Tax Law
  - Federal Securities Law
- How do we get there? This session will provide...
  - An overview of applicable rules and regulations
  - Comments regarding regulatory trends – why is this important?
  - A discussion of useful tools including checklists and policies



## Post-Issuance Compliance, Generally

- While it has always been important, post-issuance compliance is a subject that has received greater attention in recent years due to:
  - More (and more complex) rules
  - Increased enforcement activity by the IRS and SEC
    - In 2012, the SEC created the **Office of Municipal Securities** and the **SEC Enforcement Division's Municipal Securities and Public Pensions Unit**. Their singular mission is to crackdown on the municipal securities market.



## State Law

- **Expenditure of Bond Proceeds**
  - Borrowed money may only be used for the purposes for which it was borrowed (i.e., the purposes specified in the borrowing resolution)
  - Borrowed money may not be used for other purposes
  - Unspent proceeds must be used for debt service
- **Debt Service Funds**
  - Statutes require the creation and maintenance of a debt service fund for bonds
  - Tax levies (for general obligations) are to be deposited in debt service fund as they are collected



## State Law

- **Permitted Investments**

- Investment and use of money in a debt service fund is restricted to a limited class of “permitted investments” specified by State statutes

- **Record Retention**

- Issuers must keep records, including:
  - The “transcript of proceedings” (i.e., the official “record book” for State law purposes)
  - Records showing how the proceeds of bonds, including investment earnings, are spent and invested



7

## Federal Tax Law

- **Arbitrage - General**

- Arbitrage is the amount of excess earnings generated by investing bond proceeds above the yield on a bond issue
- Complying with the arbitrage regulations is a condition of maintaining the tax-exempt status of a bond issue
- Arbitrage code and regulations were created to eliminate the incentive to issue bonds for the purpose of earning arbitrage (overburdening the tax-exempt market)
- Generally applies to all tax-exempt issues and some taxable issues such as Build America Bonds



8

## Federal Tax Law

### • Arbitrage - Rebate

- The earnings in excess of the bond yield must be rebated to the IRS every five years and when the bonds are paid in full unless an exception applies.
- The potential exceptions include:
  - Small issuer exception
  - 6-month expenditure exception
  - 18-month expenditure exception
  - 2-year expenditure exception



9

## Federal Tax Law

### • Arbitrage - Exceptions

- Small issuer exception:
  - Bonds issued by governmental issuers with general taxing powers
  - \$5 million limit per calendar year
  - Additional \$10 million for school construction purposes
- 6-month exception:
  - Generally available for all bond issues
  - Spend all bond proceeds including earnings in 6 months or less



10

## Federal Tax Law

### • Arbitrage - Exceptions

- 18-month exception:
  - Generally available for bond issues with a capital project
  - Spending period schedule for gross proceeds:
    - At least 15% is spent within 6 months
    - At least 60% is spent within 12 months
    - 100% is spent within 18 months
- 24-month exception:
  - At least 75% of proceeds for construction of a project to be owned by a governmental unit or 501(c)(3) organization
  - Spending period schedule for available construction proceeds:
    - At least 10% is spent within 6 months
    - At least 45% is spent within 12 months
    - At least 75% is spent within 18 months
    - 100% is spent within 24 months



11

## Federal Tax Law

### • Yield Restriction & Temporary Periods

- Yield restriction rules generally prevent the investment of bond proceeds in “higher yielding investments” (i.e. materially higher than bond yield)
- Reasonably required reserve funds are not yield restricted
- Minor portion of an issue is not yield restricted
- Temporary periods provide exceptions to the yield restriction requirements:
  - Project Fund: if certain tests are expected to be met, unrestricted for first 3 years, restricted to bond yield + 1/8<sup>th</sup> percent after 3 years
  - Current Refunding Escrow Fund: 90 days
  - Bona Fide Debt Service Funds: 13 months



12

## Federal Tax Law

### • Arbitrage Rebate Summary

- After bonds are issued, issuers must monitor actual expenditures and investment returns to take appropriate steps as necessary.
- For Issuers that work with Quarles & Brady LLP, a simplified description of which arbitrage and rebate rules apply can be found in the “post-issuance compliance” checklist Quarles sends at the end of the financing.



## Federal Tax Law

### • Private Activity Rules

- The “private activity” rules restrict the use of bond proceeds and the use of bond-financed property by private business entities
- Any more than a minor amount (5%) of “private use” plus “private payments” can jeopardize tax-exemption
- Examples of potential private use to watch for with bond-financed property:
  - Lease or rentals of school facilities
  - Food service or concession contracts
  - Management contracts
  - Sale of naming rights on a community building or sports
  - Cell tower/antenna contracts
  - Special capacity rights or take-or-pay contracts for utility plants



## Federal Tax Law

### • Private Activity Rules, continued

- Examples of potential private payments:
  - Payments for purchase or lease of property
  - Agreements regarding minimum value or shortfall guarantees and similar development agreement provisions
  - Agreement not to challenge the amount of property assessment or tax



15

## Federal Tax Law

### • Private Activity Rules, continued

- If you work with Q&B you will receive a “Private Activity Questionnaire” at the outset of a financing, to help issue spot potential problems
- Many of these same issues apply after the financing has closed. Those are outlined in the post-issuance compliance checklist Q&B sends at the end of the financing (more on this later)
- Change of Use Rules
  - Any proposed change of use of bond-financed property involving private business (e.g., sale of a facility) should be reviewed by bond counsel.
  - A “remedial action” may be required to protect the tax-exempt status of the bonds
  - Call bond counsel



16



## Federal Tax Law

### • “Bank Qualified” Bonds

- “Bank qualified” status is a benefit to certain bond purchasers
- Can’t issue more than \$10M of bank qualified obligations in a calendar year (excluding certain refundings)
- This includes tax-exempt obligations of any sort – e.g., tax-exempt leases
- As well as bonds issued on behalf of (501 (c) (3) organizations. Borrowing by RDA, CDA or housing authority count against the municipality
- Hence, if a municipality issues \$10M (or close to \$10M) of tax-exempt “bank qualified” bonds...
- Then the Issuer must not issue more bank qualified bonds or other tax exempt obligations in the calendar year
  - Careful of tax-exempt leases
  - Careful of tax-exempt loans with the local bank
  - Call Bond Counsel with questions



## Federal Tax Law

### • IRS Compliance Checks

The IRS regularly sends compliance “questionnaires” to issuers that include questions about:

- Expenditure of funds (arbitrage/temporary periods)
- Investment earnings
- Entanglements with private business and change of use
- Record retention
- Post issuance compliance policies and procedures

The IRS also regularly audits issuers on these subjects.



## Federal Tax Law

Again, it is a very good idea to have a post-issuance compliance policy in place

(more on this later)



19

## Federal Securities Laws

- **General**

- State and local governmental bonds are exempt from the registration requirements of the federal securities laws
- But such bonds are subject to the “anti-fraud” rules which prohibit materially misleading statements or omissions in the offering document ( the "official statement")



20

## Federal Securities Laws

### • General – Review of Official Statements

- Complying with the anti-fraud rules requires Issuers to review the Official Statement used to sell bonds to investors
- This review obligation exists regardless whether the Issuer receives assistance preparing the Official Statement
- That said, the Issuer may rely on the review of its professionals in particular for special sections provided by experts (e.g., the “Tax Matters” section)
- Officials of the Issuer sign certificates attesting that the Official Statement is free of material misstatements and omissions



21

## Federal Securities Laws

### • General: Trends – Disclosure Counsel

- More and More Issuers (including in Wisconsin) ask their Bond Counsel to also act as “Disclosure Counsel” to assist them in meeting their due diligence obligation regarding review of their Official Statements
- This trend has increased in light of:
  - White papers (e.g., on unfunded pension and OPEB liability)
  - Other industry guidance regarding official statement contents
  - Enforcement actions including against individual officials
  - Detroit default and attention to bankruptcy and nature of security
  - SEC “MCDC” Initiative



22

## Federal Securities Laws

- **Disclosure Counsel:**

- Reviews the Official Statement
  - Against publicly available information
  - Courts / litigation search
  - Review of continuing disclosure compliance
- Conducts Due Diligence Call
  - Issuer completes a Due Diligence Questionnaire
- Assists in Building a Due Diligence File
- Provides a “10b-5 opinion”



23

## Federal Securities Laws

- **Continuing Disclosure – Annual Report**

- State and local governmental bond issuers may also (likely) be subject to a “Continuing Disclosure” requirement
- In most cases, the Issuer must provide an “Annual Report” each year to the bond market (through a website, EMMA)
- The “Annual Report” generally consists of (i) the latest audited financial statements, plus (ii) certain “operating data”
- See the Continuing Disclosure Agreement for each bond financing for the specific requirements



24

## Federal Securities Laws

- **Continuing Disclosure: Reportable Events**

- Issuers must also report certain events:
  - E.g., a redemption
  - E.g., a rating change

Issuers must monitor for the occurrence of these events and must report them on EMMA within 10 business days – call your financial professionals!

- All the events are listed in the Continuing Disclosure Agreement for the bond financing



25

## Federal Securities Laws

- **General: Trends – Dissemination Agent**

More and More Issuers (including in Wisconsin) employ a “dissemination agent” to assist in the preparation and filings of Continuing Disclosure reports



26

Post-Issuance Compliance Policy for Tax-Exempt and Tax-Advantaged Obligations  
and Continuing Disclosure

Adopted: \_\_\_\_\_, 20\_\_\_\_

Statement of Purpose

This Post-Issuance Compliance Policy (the "Policy") sets forth specific policies of the \_\_\_\_\_, Wisconsin (the "Issuer") designed to monitor post-issuance compliance:

- (i) with applicable provisions of the Internal Revenue Code of 1986, as amended (the "Code"), and regulations promulgated thereunder ("Treasury Regulations") for obligations issued by the Issuer on tax-exempt or tax-advantaged basis ("Obligations"); and
- (ii) with applicable requirements set forth in certificates and agreement(s) ("Continuing Disclosure Agreements") providing for ongoing disclosure in connection with the offering of obligations to investors ("Offerings"), for obligations (whether or not tax-exempt / tax-advantaged) subject to the continuing disclosure requirements of Rule 15c2-12(b)(5) (the "Rule") promulgated by the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934.

This Policy documents practices and describes various procedures and systems designed to identify on a timely basis facts relevant to demonstrating compliance with the requirements that must be satisfied subsequent to the issuance of Obligations in order that the interest on such Obligations continue to be eligible to be excluded from gross income for federal income tax purposes or that the Obligations continue to receive tax-advantaged treatment. The federal tax law requirements applicable to each particular issue of Obligations will be detailed in the arbitrage or tax certificate prepared by bond counsel and signed by officials of the Issuer and the post-closing compliance checklist provided by bond counsel with respect to that issue. This Policy establishes a permanent, ongoing structure of practices and procedures that will facilitate compliance with the requirements for individual borrowings.

This Policy similarly documents practices and describes various procedures and systems designed to ensure compliance with Continuing Disclosure Agreements, by preparing and disseminating related reports and information and reporting "material events" for the benefit of the holders of the Issuer's obligations and to assist the Participating Underwriters (within the meaning of the Rule) in complying with the Rule.

The Issuer recognizes that compliance with pertinent law is an on-going process, necessary during the entire term of the obligations, and is an integral component of the Issuer's debt management. Accordingly, the analysis of those facts and implementation of the Policy will require on-going monitoring and consultation with bond counsel and the Issuer's accountants and advisors.



27

## Post-Issuance Compliance Policies

- "Practical" Advantages:

- Create Procedures for Issuer to follow to help ensure compliance with State Law, Federal Tax Law and Federal Securities Law applicable after issuing bonds
- If there is turnover in the Issuer's administration, gives the successors a better chance to comply with these requirements
- Underwriters and investors may ask to see these procedures before bidding on and/or buying the Issuer's bonds



28

# Post-Issuance Compliance Policies

- **“Legal” Advantages:**

- Federal regulators (IRS and SEC) have a strong preference that Issuers adopt (*and follow*) post-issuance compliance policies – the IRS will regularly ask about the existence of such written policies during an audit
- Many recent enforcement actions cite lack of policies and procedures -- an Issuer may receive more favorable treatment in enforcement actions merely for having written policies and procedures
- From IRS: “Issuers should adopt written procedures, applicable to all bond issues, which go beyond reliance on tax certificates included in bond documents provided at closing. Sole reliance on the closing bond documents may result in procedures insufficiently detailed or not incorporated into an issuer’s operations.”
- From recent SEC order: “At a minimum, [issuers] should consider adopting policies and procedures that are reasonably designed to result in accurate, timely, and complete public disclosures identifying those persons involved in the disclosure process; evaluating other public disclosures that the municipal securities issuer has made, including financial information and other statements, prior to public dissemination; and assuring that responsible individuals receive adequate training about their obligations under the federal securities laws.”



Form 8028-G (Rev. 9-2011) Page 2

**Part VII Miscellaneous**

35 Enter the amount of the state volume cap allocated to the issue under section 141(b)(5) . . . . . 35

36a Enter the amount of gross proceeds invested or to be invested in a guaranteed investment contract (GIC) (see instructions) . . . . . 36a

b Enter the final maturity date of the GIC ▶ \_\_\_\_\_

c Enter the name of the GIC provider ▶ \_\_\_\_\_

37 Pooled financings: Enter the amount of the proceeds of this issue that are to be used to make loans to other governmental units . . . . . 37

38a If this issue is a loan made from the proceeds of another tax-exempt issue, check box  and enter the following information:

b Enter the date of the master pool obligation ▶ \_\_\_\_\_

c Enter the EIN of the issuer of the master pool obligation ▶ \_\_\_\_\_

d Enter the name of the issuer of the master pool obligation ▶ \_\_\_\_\_

39 If the issuer has designated the issue under section 265(b)(3)(B)(iii) (small issuer exception), check box  ▶

40 If the issuer has elected to pay a penalty in lieu of arbitrage rebate, check box  ▶

41a If the issuer has identified a hedge, check here  and enter the following information:

b Name of hedge provider ▶ \_\_\_\_\_

c Type of hedge ▶ \_\_\_\_\_

d Term of hedge ▶ \_\_\_\_\_

42 If the issuer has superintegrated the hedge, check box  ▶

43 If the issuer has established written procedures to ensure that all nonqualified bonds of this issue are remediated according to the requirements under the Code and Regulations (see instructions), check box  ▶

44 If the issuer has established written procedures to monitor the requirements of section 146, check box  ▶

46a If some portion of the proceeds was used to reimburse expenditures, check here  and enter the amount of reimbursement . . . . . ▶ \_\_\_\_\_

b Enter the date the official intent was adopted ▶ \_\_\_\_\_

**Signature and Consent**

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. I further declare that I consent to the IRS's disclosure of the issuer's return information, as necessary to process this return, to the person that I have authorized above.

Signature of issuer's authorized representative Date Type or print name and title

Firm's type preparer's name Preparer's signature Date Check  if self-employed PPTN

**Paid Preparer Use Only**

Firm's name ▶ Firm's EIN ▶

Firm's address ▶ Phone no. ▶

Form 8028-G (Rev. 9-2011)



## Post-Issuance Compliance Policy

- **Quarles & Brady LLP model policy consists of:**

- (i) A short policy, with a general statement of purpose and authorizing the development of written procedures/administrative rules; and
- (ii) Attached procedures, which can change from time to time.



## Post-Issuance Compliance Policy

- **Tax Procedures:**

- (i) Identifies a Compliance Officer,
  - (ii) Establishes recordkeeping requirements,
  - (iii) Establishes procedures for monitoring arbitrage,
  - (iv) Establishes procedures for monitoring private activity concerns,
  - (v) Establishes procedures for monitoring bank qualified status.
- The tax procedures are useful in documenting in one place what the potential tax concerns are after issuing bonds so that you can contact your bond counsel if you identify any potential concerns





## Post-Issuance Compliance Policy

- **Securities Law / Continuing Disclosure:**

- (i) Identifies a Compliance Officer,
- (ii) Requires compilation of all Continuing Disclosure Agreements,
- (iii) Requires annual review of annual reporting requirements,
- (iv) Requires establishment of calendar of reporting dates,
- (v) Establishes procedures for monitoring material events,
- (vi) Requires Compliance Officer to review all new Official Statements,
- (vii) Establishes policy for disclosure of MCDC remedial actions, and...
  
- (viii) Includes a useful checklist for all of the above.



33

## Other Best Practices to Consider

- Include duties related to bond financing and post-issuance compliance in job descriptions
- Periodic training of officials responsible for compliance
  - GFOA Publications (<http://www.gfoa.org/>)
  - EMMA training (<http://emma.msrb.org/EmmaHelp/EmmaHelp.aspx>)
- Maintain current records relating to outstanding bonds
- Call bond counsel and other financial professionals



34

## General Disclosure Policies

- The “anti-fraud” rules prohibiting material misstatements and omissions applies not only to offering documents, but also to other statements that are “reasonably expected to reach investors and the trading markets”
  - Continuing Disclosure Filings
  - Issuer Website
  - Audited Financial Statements
  - Other Statements
    - Press Releases
    - Media Interviews
    - Elected Official Speeches



## General Disclosure Policies

- Developing a general disclosure policy may help (1) reduce chance of making material misstatements or omissions; and (2) establish a reasonableness defense for any such errors
- Recent National Association of Bond Lawyer guidance suggests such a policy should include:
  - 1) description of type of disclosures covered;
  - 2) statement of process by which (and by whom) such disclosures will be drafted, reviewed, approved and documented;
  - 3) adequate supervision and disbursement of responsibilities; and
  - 4) provision for training of officials and employees
- Contact Q&B if you're interested in pursuing such a policy



## Take-Aways

- Responsibilities don't end with the closing
- There are ongoing, "post-issuance" requirements,
  - Monitoring of expenditures and investments for State Law and Federal Tax Law,
  - Retention of documents for State Law and Federal Tax Law,
  - Continuing Disclosure annual report disclosure for Federal Securities Law
  - Continuing Disclosure material event disclosure for Federal Securities Law
- Post-issuance compliance is taking on more significance in light of increased regulatory scrutiny
- Adopt a post-issuance policy! ***And then follow it!***



37

## Take-Aways

- Consider whether disclosure counsel is appropriate
- Consider whether a dissemination agent is appropriate
- Adopt a post-issuance compliance policy (Quarles & Brady can provide a model policy)
- When in doubt, call your bond counsel and finance professionals



38

## Disclaimer

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