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SEC Explains Self-Reporting Muni Enforcement Program.

BOSTON – The Securities and Exchange Commission's new program to encourage self-reporting of a specific continuing disclosure violation is facing some skepticism from bond lawyers, even as one SEC attorney said it may eventually be expanded to cover other violations.

The SEC's Municipalities Continuing Disclosure Cooperation initiative, announced March 10, would allow issuers and underwriters to get favorable settlement terms if they voluntarily report that an official statement fails to state the issuer did not file annual disclosure and operating information at some point during the past five years.

The SEC's Rule 15c2-12 on disclosure requires an OS to specify if the issuer failed, at any time during the last five years, to file annual financial information in accordance with its continuing disclosure agreement.

The MCDC program has been compared to the Internal Revenue Service's Voluntary Closing Agreement Program.

Regulators attending the National Association of Bond Lawyers' Tax and Securities Law Institute here on Thursday told bond lawyers that issuers can count on no more than a cease-and-desist order if they participate. "You can take that to the bank," said LeeAnn Ghazil Gaunt, chief of the SEC enforcement division's municipal securities and public pensions unit. Gaunt said issuers who come forward under the MCDC will be able to settle for charges of negligence rather than securities fraud, will not face financial penalties, and will generally not have to admit wrongdoing. "I think what we're trying to do is offer a reset, but we're also trying to change the landscape," she said.

Issuers who decide not to participate could face fraud charges and could be hit with financial penalties, she said. Gaunt told NABL members, who may have to counsel clients about the advisability of participating in the program, that it could take as little as two months from start to finish and shouldn't hold up any other debt issuances a municipality wants to undertake.

Some bond lawyers said the program seems to drive a wedge between issuers and underwriters. Civil penalties for underwriters who self-report are capped at $500,000 under the initiative. Regulators acknowledged on Thursday that the initiative does create "tension" between issuers and the underwriters required to review the official statement for any misstatements or omissions before underwriting any bonds. SEC muni enforcement deputy chief Mark Zehner warned that an issuer self-reporting could have consequences for an underwriter if that firm does not also acknowledge such violations in the OS.

"It's from frying pan to fire, in my view, Zehner said. If the OS is silent on the matter and there were violations in the past five years, that means the document is not really a final OS under the law and thus the underwriter violated 15c2-12, Zehner explained. He also added that an underwriter who comes forward under the program, but does not catch all the violations over the previous five years, would still be in danger of facing enforcement action for any that they missed reporting.

Some attendees expressed skepticism over the SEC's position. One lawyer asked why the SEC would further punish an underwriter in such a case, especially if the firm were self-reporting and willing to pay the maximum fine. That lawyer said piling on more punishment to a cooperative underwriter would seem to do no good for the market. Another bond lawyer asked if the Financial Industry Regulatory Authority would jump to assess penalties for conduct brought to light under the SEC program, but FINRA associate vice president and chief counsel for enforcement James Day said that has not been determined yet.

In an earlier session at the conference, SEC muni office attorney Mary Simpkins said the program might eventually be expanded to cover other types of disclosure failures. She added that the program could start a dialogue that leads to better disclosure behavior in the muni market.

"Even if there is not a lot of self-reporting, we're hoping even the discussion will help," she said.

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