

Bond Case Briefs

Municipal Finance Law Since 1971

SEC Makes Point with MCDC Settlements

WASHINGTON - The Securities and Exchange Commission, in announcing the first penalties under its disclosure violations self-reporting program last week, tried to refute criticism while providing hints about what kinds of violations are important to investors, lawyers said Monday.

The SEC announced charges against 36 underwriters for selling bonds with offering documents that contained false or misleading statements about the issuers' compliance with continuing disclosure obligations. The firms, which settled for a total of \$9.3 million, were taking advantage of the municipalities continuing disclosure cooperation, which offered lenient terms for both underwriters and issuers who self-reported any time in the last five years in which they sold or underwrote bonds with deficient offering documents.

Bond lawyers had been awaiting the settlements to see what they could learn about the SEC staff's thinking on what sorts of continuing disclosure violations were significant enough to be considered "material" and therefore require mention in a bond's official statement. There had also been criticism from some dealers and attorneys that the program targeted a problem that was already fixed when the SEC sent out a risk alert in 2012 that made clear it was paying attention to violations of its Rule 15c2-12, which requires that underwriters make sure that issuers have contracted to provide annual financial data as well as material event notices. Materiality has been defined by the Supreme Court to mean something a reasonable investor would want to know before making an investment decision.

"There were arguments by the industry that the SEC sent its message when it did the risk alert in 2012," said Elaine Greenberg, a partner at Orrick, Herrington & Sutcliffe in Washington.

In the settlements released June 18, the SEC cited examples back to 2010 but included transactions that occurred in 2013 and 2014. A securities lawyer who declined to be named said that the SEC may have chosen these examples to make the point that there are still problems in the market since the alert.

"It's almost a refutation," the lawyer said. "It's a rebuttal to those who said 'much ado about nothing.'"

Greenberg noted that the SEC's orders cite examples of financial documents filed as little as 14 days late as well as some in which the filings were never done. That means that the commission staff considers a filing late by two weeks as potentially material, she said, but it is unclear if the SEC would have pursued action if the firm had underwritten for an issuer whose only violation was a filing late 14 days.

The orders don't make reference to material events such as rating changes, but Greenberg said the market cannot take that to mean that the commission will never consider those to be material.

Robert Feyer, a partner at Orrick's San Francisco office, said that it is difficult to determine glean too much information about the SEC's views on materiality based on these settlements.

"The message continues to be that the best thing to do is comply," Feyer said.

John McNally, a partner at the law firm of Hawkins Delafield & Wood in Washington said ongoing concerns about materiality are "misplaced."

"Although we all would have appreciated further guidance as our clients considered whether to self-report under the MCDC Initiative, now that the self-reporting process has been completed, and issuers and underwriters made their determinations whether to self-report ... if there were to be a new failure to comply with a continuing disclosure agreement, the prudent course would be simply to disclose such failure without regard to where it may lie on the materiality spectrum," McNally said.

McNally also discussed previous concerns over underwriters "willfully" violating securities laws that triggered the possibility for disqualifications and detrimental effects to underwriter firms' business dealings. However, the SEC granted waivers to the firms, allowing disqualification to fade away as an issue. Feyer said it is hard to know how widespread the violations were, because some of the violations noted in the settlements could have stemmed from the poor disclosure by the same issuer.

Teri Guarnaccia, a partner at Ballard Spahr in Baltimore, noted a relative lack of competitive offerings cited in the settlements: only four firms were charged with doing sloppy due diligence in competitive deals. The SEC has taken the position in past enforcement cases that underwriters have a reduced due diligence responsibility in competitive sales because they have less time to review the documents, though it has never taken the position that the obligation isn't there. Guarnaccia said she didn't see a clear message about materiality in the settlements.

The SEC has said that more settlements with underwriters could be forthcoming, and that issuer settlements will also be coming in the future.

THE BOND BUYER

BY KYLE GLAZIER and JACK CASEY

JUN 22, 2015 3:59pm ET