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MCDC Architect Chan Makes Muni Enforcement Predictions.

PHOENIX – The Securities and Exchange Commission and Department of Justice are primed to prosecute high-ranking public officials, bond lawyers, and other non-traditional targets of municipal bond enforcement cases, according to a former SEC enforcement division lawyer.

That is the prediction of Peter Chan, a lawyer in the Chicago office of Morgan Lewis who spent some 20 years with the SEC, including as chief muni enforcer in the commission's Chicago regional office.

Chan was the architect of the SEC's Municipalities Continuing Disclosure Cooperation initiative, which incentivized issuers and dealers to self-report instances in which issuers made misleading statements about their past compliance with continuing disclosure agreements.

In a lengthy interview with The Bond Buyer, Chan said he believes there has been no slowing of momentum for muni enforcement since MCDC's end and that regulators may become even more aggressive going forward.

"I think it is quite safe to say that there continues to be consensus and momentum on SEC enforcement of the municipal securities market," Chan said.

While some market participants had wondered if the commission's attitude might shift with the departure of former chair Mary Jo White, known as an aggressive criminal prosecutor, Chan said that it appears new SEC chair Jay Clayton is on board with the enforcement division's agenda and with projects like the MCDC initiative.

"Reading the tea leaves, he does not have any problem with the initiative," Chan said.

Republicans like Clayton have been historically receptive to the idea of holding individuals accountable, Chan said, which is in line with what the SEC has been trying to shift towards for several years in either charging firm or issuer officials or explaining why it declined to do so.

"If entities commit fraud that means individuals commit fraud," Chan said. "There will be a focus on that."

The SEC has sharpened the tools it uses to hold individuals to account. The commission can charge individuals for "causing" others to violate securities laws, and it can also use the doctrine of "control person liability," which the SEC deployed to charge the mayor of Allen Park, Mich. in November 2014. Control person liability comes from section 20(a) of the Securities Exchange Act of 1934 and provides that an individual may be liable for the securities law violations of persons over whom they exercise control.

"The Public Finance Abuse Unit can use that to go up the chain," Chan said. "Not only will they focus on individuals, they will look into how far up they can go. They're not going to want to go after just a low tier bureaucrat."

The SEC has charged a number of public officials over the years, but that has rarely extended to the

upper floors of city hall.

The commission will not seek to charge an individual that way every time, Chan said, but will always be asking the question of whether it should be and taking a “holistic” view of every case.

“They basically ask a very holistic question: who are the people who contributed to the disclosure problems?”

Chan said he has observed an increasing willingness of the SEC to go after “gatekeepers” such as auditors in other markets, and expects that trend to carry over to the muni market. The SEC last year charged a New York-based audit firm and one of its senior partners in connection with municipal bond offerings by the town of Ramapo, N.Y. Bond lawyers might increasingly become targets of prosecution in some instances, too, Chan warned.

Last month, when the SEC charged Oklahoma-based municipal advisor Municipal Finance Services with breaching its fiduciary duty, the order mentioned that one offending continuing disclosure document was produced by bond a bond lawyer “who is now retired and no longer practicing law.” Chan said that could be read as a justification from the SEC as to why it was not pursuing charges against the lawyer, though it could have been contemplating them.

“I thought that was a bit of a hint,” Chan said. The SEC also charged the founder and president of the firm as well as its vice president.

When it comes to battling public corruption, the DOJ might be looking to increasingly take a page out of the SEC’s playbook, Chan added. While courts have ruled that traditional criminal public corruption charges require evidence of a quid pro quo, the securities laws, which can also be the basis of criminal charges, do not.

Prosecutors merely have to show that an official withheld a material fact, including a conflict of interest. Prosecutors could make the case that an official should have disclosed a gift from, or financial relationship with, a party to a bond transaction, Chan said.

“The DOJ is going to get pretty interested in using federal securities law to go after public corruption,” Chan said.

As for his own creation, the now-complete MCDC, Chan said he believes the SEC is likely to view it as a “resetting of the table.” The program created a major market dialogue and forced issuers to confront their past errors, and the SEC will likely expect that their message was received, Chan said.

“I don’t think the SEC will be very receptive to issuers claiming a lack of sophistication,” he said, adding that disclosure violations taking place after the MCDC’s 2014 reporting period are likely going to see harsh sanctions.

The MCDC may be a major intelligence tool for the enforcement division going forward, because so many deals were reported. The SEC has computer analytical tools to allow it to sift through that data and find things it might not otherwise have discovered, he said. The commission has used big data analytics in other markets and the public finance unit has those tools now as well.

“They are likely applying that same type of big data analytics to the treasure trove of data they received,” Chan said.

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